979-80/46 [H.A.S.C. No. 96–46]

HEARING

ON

H.R. 7247

TO WAIVE THE APPLICABILITY OF SECTIONS 2382 AND 7300 OF TITLE 10, UNITED STATES CODE, TO CONTRACTS FOR THE CONSTRUCTION OR MANUFACTURE OF NAVAL VESSELS OR MILITARY AIRCRAFT WITH RESPECT TO WHICH FINAL PAYMENT IS MADE BEFORE OCTOBER 1, 1981

BEFORE THE

INVESTIGATIONS SUBCOMMITTEE

OF THE

COMMITTEE ON ARMED SERVICES

HOUSE OF REPRESENTATIVES

NINETY-SIXTH CONGRESS

SECOND SESSION

JUNE 25, 1980

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HOUSE OF REPRESENTATIVES,
COMMITTEE ON ARMED SERVICES,
INVESTIGATIONS SUBCOMMITTEE,
Washington, D.C., Wednesday, June 25, 1980.

The subcommittee met, pursuant to notice, at 10 a.m., in room 2118 of the Rayburn House Office Building, Hon. Samuel S. Stratton (chairman of the subcommittee) presiding.

OPENING STATEMENT OF HON. SAMUEL S. STRATTON, A REPRESENTATIVE FROM NEW YORK, CHAIRMAN, INVESTIGATIONS SUBCOMMITTEE

Mr. STRATTON. The subcommittee will come to order.

The subcommittee meets this morning to begin consideration of H.R. 7247, a bill to waive the applicability of secs. 2382 and 7300 of title 10 of the United States Code, to contracts for the construction or manufacture of naval vessels or military aircraft with respect to which final payment is made before October 1, 1981. This legislation was filed by Chairman Price on May 1, of this year.

These sections of title 10, to which the chairman's bill is addressed, are sometimes referred to as the Vinson-Trammell Act. I trust the subcommittee will indulge me if I enter a mild demurrer to the use of this name for the legislation in question, the use that has been carried out largely I see by those whose association with the work of the Congress dates well after the Second World War.

Actually, for those of us of more senior vintage, the Vinson-Trammell Act was a rather historic piece of legislation authored by the venerable Carl Vinson, former chairman of the House Armed Services Committee, back in 1934. It really provided the original basis for the development of the two-ocean U.S. Navy which eventually won World War II for us, with, I will concede, some minor assistance, of course, from the U.S. Army.

Most significantly, from today's congressional point of view, the Vinson-Trammell Act provided a blanket authorization for naval shipbuilding spelled out in terms of a fixed, total ship tonnage figure. So long as the Navy's total active shipping did not exceed that ceiling figure, the Navy did not have to come back to Congress, as they do today, for specific ship authorizations, something that we certainly would look askance at today, but which was of great value as it turned out in creating a modern U.S. Navy back at the same time that I was entering college.

Several other subsidiary provisions were also included in this comprehensive legislation. One of them provided, for example, that new Navy ships should be built alternately in naval shipyards and in private shipyards, a precaution taken by an earlier and, undoubtedly, wiser generation that would, had it been retained, have prevented the closing of the Brooklyn Navy Yard and the Boston Navy Yard, to

mention only a few whose exploits are now vanished, unfortunately, into history.

Another provision of the Vinson-Trammell Act rigidly limited the profits of private shipbuilders and aircraft manufacturers, as well as their subcontractors, on naval ship and aircraft construction. The act imposed profit limitations of 10 percent on the construction of naval vessels and naval aircraft.

In 1959, Congress provided for a current annual authorization process for the procurement of military weapons, including ships and aircraft; and in 1965, the broad authorization grant provided under Vinson-Trammell tonnage ceilings for the Navy was repeated to require prior authorization of all subsequent naval construction.

Today, the Vinson-Trammell Act has been codified in various sections of title 10, United States Code. Although the division of construction between Government-owned and private shipyards remains in effect, the President routinely waives this requirement as not being in the public interest. I am not quite sure how he waives that requirement, whether a waiver is included in the law or whether this is just typical of what happens these days when the White House does not like what the Congress is doing.

The profit limitations which it incorporated are now contained in two sections of title 10, United States Code. Section 2382 provides a current 12-percent profit limitation on contracts and subcontracts for the construction of all or part of any military aircraft. Section 7300 imposes a 10-percent profit limitation on contracts and subcontracts for construction of all or part of any naval vessel.

These two sections are all that remain effective today of the Vinson-Trammell Act, and I suppose from that point of view, it is not entirely unfair to refer to them as though they represented the more comprehensive and more historic piece of legislation which has been known by that name for over three decades. However, it bothers me a little bit to see these secondary portions of a very famous piece of legislation, authored by a very famous and still living, former member of this body and distinguished chairman of this committee, designated by the name of Vinson-Trammell.

Perhaps, however, it is beneficial in the long run that the name of Vinson-Trammell should be retained because Mr. Vinson, as those of us who have had the pleasure of serving with him are well aware, throughout his long and distinguished congressional service, and although he was one of the strongest exponents of defense production of what would be called, although they did not have the term in his day, an unreconstructed hawk, was also an equally intense defender of the idea of a reasonable and a fair limitation on profits achieved through defense contracts.

In 1951, the profit limitation sections referred to above were superseded, although not repealed, by the Renegotiation Act of 1951. Incidentally, Mr. Vinson was a strong supporter of the Renegotiation Act and a vigorous opponent of efforts to repeal it.

The Renegotiation Act established a procedure whereby the Renegotiation Board reviewed the aggregate fiscal year profits of Government contractors to reduce excessive profits. Although the Renegotiation Act expired several times, it was extended retroactively each time

until September 30, 1976, and by that time Mr. Vinson had long been gone from the Halls of the House of Representatives, and the Congress did not further extend its provisions.

With the expiration of the Renegotiation Act, the profit limitation sections of the old Vinson-Trammell Act, now incorporated in sections of the United States Code, title 10, thus technically came back into effect as of October 1, 1976. In fact, I am not sure what we mean by "technically." They came back into effect, they were in effect, and they are in effect, although nobody in the executive branch seems to be regarding them as being part of the law or worthy of any particular implementation.

However, additional funding was provided for the Renegotiation Board to continue operations until March 31, 1979, so that it might examine items which predated September 30, 1976.

While it is generally agreed that the specific profit limitation provisions of Vinson-Trammell, as it now exists, may be outdated, let me say that there is sharp disagreement over what adjustments may be necessary. Many contractors have expressed the view that no profit limits at all should be imposed on a contract after it has been negotiated and awarded. In contrast, many others both in and out of Government believe that profit limitations are still both necessary and desirable, particularly in view of our recent experiences with overruns, buy-ins, and "get well" cost claim filing. In fact, this subcommittee has spent about 2 months in examining a situation which is directly responsive to those particular designations.

I have discussed Mr. Price's bill with the chairman, and we agree that because the subject of profit limitations is both exceedingly complex and controversial, that the committee should have adequate time to make a comprehensive examination of the subject. He suggested that the subcommittee conduct in-depth hearings regarding the whole issue early in the 97th Congress. His bill is based on the belief, he said, that a temporary waiver of the profit limitation provisions would allow the subcommittee time to hear the views of various Government agencies, contractors, and procurement experts.

On the other hand, it may be preferable not to have a full waiver, but a temporary and possibly somewhat more realistic new ceiling. I am not myself sure which would be preferable, but I do feel very strongly that once we were to put a waiver into effect, and if the subcommittee should then conclude that some profit limitation is advisable, then after all, as Mr. Vinson tried for years to convince the committee and the House of Representatives, it would then seem to me to be virtually impossible for Congress to put the spilled milk, or if you prefer the profit genie, back into the bottle.

Now, perhaps I might underline—as refuting a report that appeared in the press this morning which suggested that this hearing today is just a kind of demonstration charade for allowing the House to succumb to the Senate and to take off any limitation whatsoever on defense contracts—that issue certainly has not been agreed upon, and certainly not by the chairman of this subcommittee.

The Internal Revenue Service currently has enforcement responsibility for the profit limitation sections of the old Vinson-Trammell Act. But for some reason I don't understand, the IRS, which is usually

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a terror when it comes to tracking down failures to pay taxes, has been delaying the implementation of this particular provision because it recognized, or said, or felt there were inherent limitations in the act and difficulties of enforcement. And this is one of the things we will look into at this hearing.

[Following is the Washington Post article of June 25, 1980:]

[From The Washington Post, June 25, 1980]

TAX BREAK NEARS FOR ARMS CONTRACTORS

(By T. R. Reid)

While economists ponder the wisdom of a general tax cut next year, Congress is moving toward swift enactment of a retroactive tax cut for a select group of defense contractors.

A House Armed Services subcommittee has scheduled hearings for today on legislation—already approved by a Senate committee—that would suspend application of the Vinson-Trammell Act, a tax statute that requires contractors to repay any excess profits—defined as more than 10 percent on ships or 12 percent on aircraft—earned on contracts with the Pentagon.

The bill's passage seems certain, a tribute to the hard work of defense industry lobbyists, who have battled successfully to keep the government from collecting the profits tax since it went into effect four years ago.

Actually, the lobbyists would have preferred an outright repeal of the profits tax, but that seems politically impossible just four months before every House members must face the voters. "The only pressure I know of against outright repeal," said Rep. Paul N. McCloskey Jr. (R-Calif.), "is the concern that in an election year, defense contractors will be perceived as getting a special favor from Congress."

Accordingly, the pending legislation provides only for a temporary suspension of the law until October 1981. By then, McCloskey and other industry allies hope to have convinced the new Congress to repeal the tax for good.

The political concern is so great that the lobbyists and their congressional supporters have devised a way to pass the tax-cut bill without the need for a floor vote.

"It's all wired," said Rep. Joseph G. Minish (D-N.J.), the most outspoken House supporter of continued profit controls. "They hold this quickie hearing, and then the House guys use that to go along with the Senate bill in conference."

Translation: When the Senate legislation suspending the profits tax—an innocuous paragraph buried deep with a $52 billion procurement bill—goes to a House-Senate conference committee, House conferees will accept the Senate-passed provision. This way no separate House vote on the profits tax will be needed.

One reason legislation suspending the Vinson-Trammell profits tax seems sure to pass is that nobody—not even advocates of the concept of taxing excess profits—defends the obscure and inflexible profit-control system incorporated in that statute, which was passed in 1934.

Proponents of defense profit controls—including the Pentagon's top contracting officers and the Defense Department's resident gadfly, Adm. H. G. Rickover—want Congress to pass a revised profits tax to replace Vinson-Trammell. But those who oppose any tax on excess profits seem to have the upper hand in both Houses now.

Four years ago, in response to a strenuous grass-roots lobbying drive by defense contractors and subcontractors in every state, Congress acted to kill the Renegotiation Board, a tiny federal agency that was recouping about $40 million annually in excess profits from Pentagon contractors.

The Renegotiation Board was considered an alternative to the Vinson-Trammell tax, and so the tax was suspended during the board's lifetime. When the agency was killed, in September 1976, contractors once again became legally bound to pay the profits tax.

But no firm has yet paid a penny of tax, because the Internal Revenue Service and the Defense Department have yet to issue regulations to govern its collection.

Dale W. Church, a deputy undersecretary of defense, explained candidly to a

Senate committee this spring why the agencies had spent four years working on the regulations.

"We in the Department of Defense are simply stuck with the Vinson-Trammell Act," Church said ". . . we have been moving rather slowly in trying to look at the many facets of it and trying to come up with a regulation or procedure which is the . . . least onerous on our contractors."

Because the government has not tried to collect the tax, no one seems sure how onerous it would be. Contractor organizations say almost no tax would be collected, because other defense procurement laws prevent firms from earning high profits. But the Defense Department says some form of after-the-fact control of contract profits is needed to prevent profiteering.

We track relentlessly a fellow selling bait or worms for fishing in New York State, but at the present time nothing has been done about enforcing the profit limitation provisions of the United States Code. The defense suppliers are supposed to file reports under the act with the IRS by October 15, 1980, but presumably they will not be treated in the same way as those of us who fail to file our reports by April 15.

Defense contractors and subcontractors are in the untenable position, therefore, of not knowing what kinds of records must be maintained, let alone knowing what will be needed to file. Consequently, the contractors and subcontractors are unsure of their financial status and are unable to provide a complete financial report to their stockholders. Now, Mr. Price believes that this bill would ease the apparent problem the contractors are having, while allowing the subcommittee an opportunity to examine the alternate courses and then report out effective legislation, subject, however, as I have already pointed out, to the fait accompli complications of the chairman's bill.

Once the genie is out of the bottle, I am not sure what will happen to the public interest with all of the pressure we have been subjected to in undertaking these hearings for the purpose of eliminating the last vestige of any limitation on defense contracts. And it seems most unlikely that there will be any majority in the House of Representatives, let alone the Senate, to put back some alternate course which the subcommittee, after extensive hearings in 1981, might feel desirable.

Now, since the subcommittee intends to examine the profit limitation provisions in detail in the 97th Congress, we would ask that today's witnesses confine their testimony to the merits or lack thereof in H.R. 7247.

[H.R. 7247 is as follows:]

[H.R. 7247, 96th Congress, 2d session]

A BILL To waive the applicability of sections 2382 and 7300 of title 10, United States Code, to contracts for the construction or manufacture of naval vessels or military aircraft with respect to which final payment is made before October 1, 1981

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the provisions of sections 2382 and 7300 of title 10, United States Code, relating to profit limitation on contracts for the construction or manufacture of aircraft and naval vessels and parts thereof, shall not apply with respect to any contract for the construction or manufacture of all or any part of any aircraft or naval vessel with respect to which final payment is made before October 1, 1981, or to any subcontract of such a contract.

Mr. STRATTON. We will commence our hearings with the testimony from several of our colleagues who have been concerned with the Renegotiation Act and/or the profit limitation provisions of the Vinson-Trammell Act. Unfortunately, I do not see the first witness, Mr. Minish from New Jersey, who is the senior member and who

is a strong supporter of Vinson-Trammell. The others who have requested the opportunity to testify are not here either, except one of the strongest supporters of repeal, our distinguished colleague, Mr. McCloskey.

Therefore, Mr. McCloskey, we would be very happy to have your testimony at this time.

STATEMENT OF HON. PAUL N. McCLOSKEY, JR., A REPRESENTATIVE FROM CALIFORNIA

Mr. McCLOSKEY. You have a copy of the 3½-page statement that I have submitted. I think rather than read it in its entirety, I will refer to the three specific points of difference.

Mr. STRATTON. It may be included in the record.

Mr. McCLOSKEY. This is between the Senate language that has been passed—the language in Chairman Price's bill—and the language which I would propose be substituted solely for the purpose of the moratorium over the next 15 months.

It seems to me we are talking in this hearing about the next 15 months. The sole question is how to preserve productivity of the defense contracting industry against the concern of Mr. Minish and others, that somehow there would be undue profits taken which cannot be recaptured if the moratorium language is not appropriately drafted.

Here, Mr. Chairman, I would go back to the reports of the Renegotiation Board for the 3 years prior to its termination. As you may remember, a majority of our colleagues, 224 Members of the House, asked Chairman John Slack to appropriate no further funds for the Renegotiation Board. The basis for that request was an expenditure of approximately $250 million by the defense industry, 4,500 contractors and subcontractors that were filing reports each year, against a net recovery to the Government of perhaps an average of $10 million per year by the Renegotiation Board. Presumably at least 48 percent of that $10 million per year of excess profits would have come to the Government in income taxes anyway.

So the net expenditure of the industry of over $250 million per year under the Renegotiation Board, as opposed to the minimal recovery by the Government, caused most of our colleagues to agree that we ought to terminate the process.

I think the same holds true with respect to Vinson-Trammell. Clearly, the Congress here is doing what the administration has been unable to do. It is no secret, as the chairman has pointed out, that since September 30, 1976, the administration had knowledge that Renegotiation might not be renewed by the Congress.

They have now had over 15 months since March 1979 to come up with some sort of answer on how to enforce Vinson-Trammell, if at all. The fact that the Congress is having to move into this area is a demonstration that the administration is almost as incompetent in this field as it is in others.

What should the Congress do?

The fact is that during the last 3 years of the Renegotiation Board, out of 4,500 subcontractors and contractors, in only 25 cases did a

contractor make a profit of over 15 percent on sales above $5 million. Therefore, it would be bizarre, in my judgment, to impose on an industry a regulation which may require millions of dollars in accounting and legal costs to comply with in order to hit a few contractors that might make over 15 percent profit.

I think the language this committee should adopt, as I point out on page 4 of my testimony, is that Vinson-Trammell shall not apply to any contract or subcontract entered into after September 30, 1976, and before October 1, 1981.

That does let everybody off the hook for the next 15 months. However, one contractor in my district has estimated that if the Senate language is adopted, their cost could be $10 million per year in recordkeeping costs.

If the language of the Price bill is adopted, it may cost that same contractor $15 million. The only people who benefit by that recordkeeping are the attorneys and the accountants that must maintain the records to comply with Vinson-Trammell.

If that cost is spread across the board, then there would be hundreds of millions of dollars in recordkeeping done by conscientious, cautious subcontractors over the next 15 months, in order to cover the Congress against the possibility that perhaps a few contractors might be liable for profits of over 15 percent, assuming that is we adopt a 15-percent limitation next year when this committee has had a chance to study it carefully.

I think, Mr. Chairman, that these accounting procedures may well cost the U.S. taxpayers $250 to $300 million, because sure as hell, we are going to pay in defense procurement the cost of the accounting and legal procedures.

We ought to be on the side of cutting the known administrative costs, rather than being concerned over undue profits which were not demonstrated during the last 3 years of the Renegotiation Board's operations.

The essence of my testimony is to reject the Senate language and propose the language on page 4 of my testimony in place of the proposed language that the chairman has in this bill.

WRITTEN STATEMENT OF HON. PAUL N. MCCLOSKEY

I appreciate the opportunity to testify on your bill, H.R. 7247, to stay implementation of the Vinson-Trammell bill until October 1, 1981.

It is understood that the purpose of the bill is to legitimize on one hand, the Administration's obvious inability, if not unwillingness, to draft simple and enforceable regulations for an outdated law, and on the other hand, to assist several thousand government contractors to avoid undue legal and accounting costs to cope with both the Administration's indecision and the fact that no sane person can anticipate what regulations such an Administration might draft to define compliance.

It is agreed in both Houses of Congress that the Administration's delay and indecision, following expiration of the Renegotiation Board's authority on September 30, 1976, coupled with the workload prior to adjournment this October, make it impossible to hold the careful and comprehensive hearings required for a new law to replace Vinson-Trammell. It is likewise agreed that there should be a reasonable moratorium to permit those hearings early in the 97th Congress, with Vinson-Trammell to be either repealed or amended before the moratorium expires.

The only bill actively under consideration to amend Vinson-Trammell is one which imposes a 15-percent profit limitation on all sole-source contracts of $5 million gross receipts or over. Against the background, what form should the moratorium take?

The Senate Armed Services Committee, on June 20, reported out specific language in the Defense Authorization bill, providing that Vinson-Trammell:

> Shall not apply to any contract or subcontract the performance of which was completed during the period beginning on October 1, 1976, and ending on September 30, 1981.
>
> Neither DOD nor the IRS may require any report . . . nor . . . promulgate any regulation . . . for . . . implementation . . . before October 1, 1981,

I have appended as Exhibit A to this testimony that testimony I presented to the Senate urging abolition of Vinson-Trammell on April 2, 1980. The reasons for abolition rather than amendment are well known but not necessary to repeat here.

In your bill, Mr. Chairman, the language differs slightly from the Senate's bill.

You exempt contracts for which "final payment is made before October 1, 1981" rather than contracts completed before October 1, 1981.

Also, you include no prohibition against DOD or IRS issuing regulations before the moratorium ends.

I am assuming that on this latter point, you would agree to the additional Senate language, since the purpose of the bill is to permit Congress to act in time to give guidance to the DOD and IRS on how any new regulations should be written.

I hope you will also agree to the Senate language exempting subcontracts independently of prime contracts. In many cases, subcontracts may be completed well in advance of the October 1, 1981 deadline but, because the prime contract is not completed, would still be forced to comply with Vinson-Trammell. I would recommend, therefore, that your bill be amended to read, "shall not apply with respect to any contract or subcontracts."

With respect to whether the moratorium language should be "completed by" or "for which payment is received by," it seems to me that neither phrase is much help to the defense contractors in the 15 months between now and when the law will become clarified.

Few contractors or subcontractors will be engaged solely in performance only of contracts they can be assured will be either completed or fully paid for by October 1, 1981. The careful and cautious contractor will have to maintain records of some kind on all existing or new contracts where any doubt exists. But what kind of records? With what future standards will they have to comply?

If they rely on passage of the presently-drafted sole-source, 15 percent limitation bill, nearly all existing new sole-source contractors and their subcontractors, if they err on the side of caution, will have to keep records, the cost of which will be borne by the government.

It was just this cost . . . estimated in the range of $250 million as compared to the government's average annual net recovery of perhaps $7 million . . . that led the House to abolish the Renegotiation Board last year.

During the last 3 years of the Renegotiation Board's existence, only 7 cases were recorded where any contractor made a profit of over 15 percent, with some 3,500 to 4,500 contractors falling within the reporting requirement each year.

Under these conditions, it would seem worthwhile, in creating a moratorium because of the Government's conceded failure, that maximum protection be provided against both excess cost imposed on the contractors and resulting excess costs to the Government. The chances of excess cost are certain, and seem far greater than the danger that an excess profit will be gained during the 15 months in question.

One contractor in my district has estimated that the Senate language, if adopted, will cost them about $10 million in record keeping costs, and that your bill will cost $15 million. This is only one contractor, and a relatively small one. They have never been assessed for excess profits under the Renegotiation Act, and don't expect to make over 15 percent on any sole-source contracts they may receive in the future.

Accordingly, Mr. Chairman, I would recommend changing the language in both the Senate bill and your own, to read:

> Shall not apply with respect to any contract or subcontract entered into after September 30, 1976, and before October 1, 1981.

This is the only language which would permit the nation's 4,500 defense contractors and subcontractors to avoid undue and unnecessary accounting expense during the next 15 months.

If productivity is to be our primary goal in the 1980s, Mr. Chairman, I think simplification of law and regulation must be our own major goal. Lawyers and accountants do not contribute to productivity. In the present case, the cost of lawyers and accountants to cope with a 1934 law which both the Administration and Congress concede to be unworkable is both a challenge to our legislative abilities and a source of embarrassment if we can't end it . . . at least for 15 months.

Thank you for the privilege of giving this testimony.

EXHIBIT 1

Statement of Representative Paul N. McCloskey, Jr. Before the Senate Armed Services Committee—April 2, 1980

Mr. Chairman: I appreciate this opportunity to testify on the Vinson-Trammell Act, which was reinstated into the relationship between the government and the defense contracting industry when Congress cut off funding for the Renegotiation Board a year ago.

The Vinson-Trammell Act is clearly obsolete and would be extremely costly to administer. Enacted in 1934 when aircraft manufacture was in relative infancy, Vinson-Trammell limits profits on ship components to 10 percent and aircraft to 12 percent, but imposes no limits on profits from other components provided to the government.

Thus a defense radio manufacturer, for example, under Vinson-Trammell, would have to maintain three sets of records: (1) cost allocable to radios furnished for the aircraft, (2) radios furnished for ships, and (3) radios furnished for other purposes.

In today's world, the costs of such record-keeping are obviously a burden we don't want to impose at a time when productivity of U.S. industry is a major goal. This was the very reason we abolished the Renegotiation Board last year; the $200-plus million costs per year of industry just didn't match the net recovery of $10 million or so per year we might reasonably have expected as the result of the Renegotiation Act.

In my judgment, the Vinson-Trammell Act should be abolished as well.

The Defense Department has declined, as far as I know, to offer any testimony, or even suggest, that current law and procedures create any danger of excess profits by defense contractors.

Unless Vinson-Trammell is abolished, the Treasury Department, under current law, will have to apply Vinson-Trammell to contracts going back to September 30, 1976.

S. 1687 introduced by Senators Lugar and Cranston, will accomplish this result. I have appended a copy of H.R. 3254, an identical bill, as Exhibit A to this testimony.

You also have before you a bill similar to Congressman Patterson's bill, H.R. 5433, which would repeal Vinson-Trammell, but substitute a profit limitation of 15 percent on all sole-source contracts over $5 million . . . roughly 2,000 out of 147,000 sole contracts which add up to roughly $40 billion this year. As I understand it, this is merely an attempt to be political in an election year. The Defense Department makes no contention that any of these 2,000 contracts . . . presently, last year, going back to September 30, 1976 or in the future . . . will result in profits over 15 percent. In fact, during the last few years the Renegotiation Board was operating, the firms assessed for excess profits (quite often under 15 percent) were generally small firms, with contracts well under the $5 million limit, and quite often competitive rather than sole source.

Before a new regulatory limitation or procedure is placed on American businesses, it seems to me there should be some showing (other than fear of adverse press) that such limitation is necessary.

Since Vinson-Trammell was enacted we have seen a whole set of laws enacted to protect the government from gouging by defense contractors. Cost Accounting Standards, the Armed Forces Procurement Regulations and the Truth in Negotiations Act all work to assure that the government will not be victimized. In non-emergency circumstances, with contract negotiations conducted without time pressures, there seems to be ample protection against gouging. In the few cases where these protections may permit unexpected profits in excess of 15 percent,

the government should ordinarily recover 48 percent of those profits anyway under the income tax laws.

Without a showing of great risk, or indeed of any risk to the government under past practices, why should we impose a future record-keeping burden on industry as a result of some fear that someone will foul up in the future?

Such a burden might conceivably cause government procurement officers to be a little less rigorous in their scrutiny of sole-source contracts, since there will be an escape-valve for the government. Instead of being accountable for his mistakes, the procurement officer can relax in the knowledge that bureaucrats in another agency will bail him out.

In lieu of passing a new Vinson-Trammell, I would suggest that this Committee act to make it clear that the Renegotiation Board can be re-established in event of any future national emergency. This would give protection against future excess profits under emergency circumstances, yet confirm both our appropriation action cutting off the Renegotiation Board last year as well as the continuing process of abolishing pieces of government that most of us have promised our constituents to achieve.

I have attached as Exhibit B to this testimony the House bill which confirms our desire to have the Renegotiation Board on the shelf for such national emergency as the Vinson-Trammell Act would otherwise be applicable.

Thank you.

PAUL N. MCCLOSKEY, JR.

EXHIBIT A

[H.R. 3254, 96th Cong., 1st sess.]

A BILL To amend title 10, United States Code, to eliminate certain limitations imposed on excess profits arising from any contract with any military department of the United States for the construction or manufacture of all or part of any complete aircraft or any contract with the Secretary of the Navy for the construction or manufacture of all or part of any complete naval vessel, and for other purposes

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) section 2382 of title 10, United States Code, is repealed.

(b) The table of sections at the beginning of chapter 141 of title 10, United States Code, is amended by striking out the item relating to section 2382.

SEC. 2. (a) Section 7300 of title 10, United States Code, is repealed.

(b) The table of sections at the beginning of chapter 633 of title 10, United States Code, is amended by striking out the item relating to section 7300.

SEC. 3. (a) Section 7342 and 7343 of title 10, United States Code, are repealed.

(b) The table of sections at the beginning of chapter 635 of title 10, United States Code, is amended by striking out the items relating to sections 7342 and 7343.

SEC. 4. The provisions of the first section and of section 2 of this Act shall apply to contracts entered into after September 30, 1976.

EXHIBIT B

[H.R. 3112, 96th Cong., 1st sess.]

A BILL To amend the Renegotiation Act of 1951 to provide that such Act shall only be in effect when the President, during a period of national emergency, determines that having the provisions of such Act in effect would be in the best interest of the country

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the Renegotiation Act of 1951 (50 App. U.S.C. et seq.) is amended by adding at the end thereof the following new section:

"SEC. 205. (a) The provisions of this Act and any recommendations of the President submitted to the Congress pursuant to subsection (b) shall be in effect only when—

"(1) the President determines, during a period of national emergency, that having such provisions in effect would be in the best interest of the United States, and

"(2) neither House of the Congress, within sixty days after the date on which the President submits such determination to the Congress in accordance with subsection (b), passes a resolution disapproving of such determination.

"(b) Upon making a determination under subsection (a), the President shall—

"(1) inform the Congress of such determination, and

"(2) recommend to the Congress any amendments to this Act which he determines are necessary during such period of national emergency.".

EXHIBIT C

During the last three complete years of the Renegotiation Board (1976, 1977 and 1978), 132 companies were assessed for excess profits. In only 7 of those 132 cases, however, did profits exceed 15 percent on sales above $5 million. If those profits in excess of 15 percent were all made on sole-source contracts, an average of $528,373 per year would have been recovered by the DOD proposal over the three year period beyond what normal income taxes would have recovered.

If the costs of complying with DOD's proposed replacement of Vinson-Trammell will cost substantially more than $500,000 per year to the contractors (and be passed on to the government), there would seem to be little reason to adopt the DOD proposal.

	Companies assessed for excess profits	Companies subject to DOD proposal	Profits as a percentage of sales	Profits recovered by DOD proposal	Net profits recovered by DOD proposal (after income taxes)
1976	46	0	0	0	0
1976 (transition quarter) (total)	12	1	16.8	$100,332	$52,173
1977	37	2	18.5	2,159,640	1,123,013
			15.4	29,572	15,377
Total, 1977				2,189,212	1,138,390
1978	37	4	15.6	48,048	24,985
			16.0	341,150	177,398
			16.9	172,444	89,671
			17.0	197,120	102,502
Total, 1978				758,762	394,556
Total, 1976–78				3,048,306	1,585,119
Average per year over 3 yr				1,016,102	528,373

Mr. STRATTON. Thank you, Mr. McCloskey.

You say that the reason for wanting to eliminate any limitations on the profits of defense contractors whatsoever is because of a lack of productivity in our defense industry. What do you base that statement on?

I have not been aware of the lack of productivity. We have been a little skimpy in putting contracts out for construction, but we seem to be turning the corner a little bit.

Mr. MCCLOSKEY. Let me give you a specific in shipbuilding.

Mr. STRATTON. What industries are lacking in productivity?

Mr. MCCLOSKEY. Mr. Chairman, we have had problems with naval shipbuilding all around the shipyards of the United States. For the last 4 years, as the ranking member on the Maritime Committee, I have looked at productivity in these heavily subsidized shipyards.

We found, for example, that shipyard owners will say privately that when they bid on a subsidized ship or on a Navy ship, they may add 50 percent to the cost of their bid because of the paperwork and the inspections they will go through in dealing with the Government regulations on that production.

I think when we talk about productivity that we are talking about legal and accounting costs primarily to comply with Government regulatory requirements. It is that aspect of productivity that I speak of.

If you impose regulations on business that require the hiring of accounting staffs and legal staffs of undue size, to that extent you hurt productivity.

The only figure I have heard is from the shipyards themselves. They will say the problems of dealing with the Government of the United States, under the multilayer of regulations, may add as much as 50 percent to the cost of their bid. This is just to cope with the Government regulations involved.

Mr. STRATTON. So, we should not have any regulations when we turn the contracts over to a shipbuilder? We should just let them do what they want? Is that your suggestion?

Mr. MCCLOSKEY. No, I do not make that suggestion.

Mr. STRATTON. That is what we should do at Newport News and at Litton?

We have billions of dollars in claims that have been filed. Those are the result of Government regulations? And if we took off the regulations, we would get many more ships built more rapidly?

You say we should not let the Navy try to tell the shipbuilder what to put on the ship, but leave it up to him.

Mr. MCCLOSKEY. Mr. Chairman, I suggest when you look at the shipbuilding industry, you find out what percentage of the cost of building a Navy ship is attributed by the shipyard itself to the regulatory restrictions that apply to the construction. The figures have been 50 percent.

Mr. STRATTON. Are those the restrictions that have been imposed by this legislation, or are you imposing the insistence of the Bureau of Ships on performance in accordance with contracts?

Mr. MCCLOSKEY. I do not know, Mr. Chairman. You asked me a question as to on what I base the statement that the productivity of our defense subcontractors and contractors is materially hurt by government regulation. The only example I can cite to you is from the shipbuilders themselves who have pointed out the 50-percent cost that they feel goes into a ship.

Mr. STRATTON. You are not talking about the 50-percent cost that is the result of the existence of Vinson-Trammell or the Renegotiation Board; are you?

Mr. MCCLOSKEY. No; the problem with Vinson-Trammell is, you cannot predict what the costs will be.

Mr. STRATTON. Getting back to productivity, you are saying that the shipyards are unproductive because of government regulations.

Now, we are talking about a specific government regulation; namely, a limitation on profits. You are not saying that is the one they are complaining about; is that right?

Mr. MCCLOSKEY. As you know, Vinson-Trammell has not been enforced since 1939. In the 5 years that Vinson-Trammell existed before it was superceded by the Renegotiation Board, there are no real clear indications it benefited the country.

Mr. STRATTON. The only other regulations are insistences by the Navy that a ship be built according to certain specifications. Now, if those are onerous regulations, I do not know how the taxpayers can insist they are going to get a return for their particular dollar if they do not have inspectors down there, and if they do not make certain that the ships and the planes and the C–5A are built in accordance with their specifications and in accordance with the contract.

Is it an onerous regulation that we should insist a contract be carried out in accordance with its provisions?

Mr. MCCLOSKEY. Now, Mr. Chairman, when you compare the two—and I cited the shipyard case as an example where the shipyards themselves feel their productivity has been hurt by excessive government regulations—the test in each case is really, is it cost-effective or not.

In Vinson-Trammell, there we have only the experience between 1935 to 1940 as to whether Vinson-Trammell was effective. We urge here, and the chairman urges, a moratorium for the next 15 months on Vinson-Trammell, with some reflection back on the 3½ years that preceded this.

The only knowledge we have of Vinson-Trammell is that its costs would interfere with productivity. That presumably is the reason the IRS and the Defense Department have been unable to agree on regulations.

How would you keep records, for example, if you make radios and the radio goes into a tank and there is no profit limitation? The radio goes into a ship and there is a 10-percent profit permitted. In an aircraft, it is a 12-percent profit. Just maintaining those records is going to be an undue cost on industry. That is the purpose, as I understand it, that we are trying to end with this moratorium.

Mr. STRATTON. You say the experience of the Vinson-Trammell Act demonstrates the problems, but you also said the Vinson-Trammell Act has not been adhered to. We have done nothing about it since the Renegotiation Board expired. We, therefore, have no experience.

Where do you get your figures that the cost of operating the Renegotiation Board was $280 million, and it only recovered $10 million for the $280 million expended?

Mr. MCCLOSKEY. Those figures on the Renegotiation Board came from two companies; one, a relatively small company in Portland, Oreg., and the second, the Hewlitt-Packard Co. whose computations were challenged by the Renegotiation Board. They were audited by the GAO, and the GAO reported there was insufficient evidence to challenge Hewlitt-Packard's conclusions. They showed that the cost for keeping the records for the Renegotiation Board computations of making reports each year, and keeping the records if imposed against all of the contractors in the United States, would exceed, as I recall, $250 million, and the cost of record that the Renegotiation Board would recover about $10 million in any given year.

Mr. STRATTON. Could you make that information available to the committee?

Mr. MCCLOSKEY. Yes, I will be glad to. It will be detailed information for the committee. I think it was 3 years ago.

65-260 - 0 - 80 - 2

[The following information was received for the record:]

CONGRESS OF THE UNITED STATES,
HOUSE OF REPRESENTATIVES,
Washington, D.C., June 30, 1980.

Re Vinson-Trammell.

Hon. SAMUEL S. STRATTON,
Chairman, Subcommittee on Investigations,
Committee on Armed Services, Washington, D.C.

Dear Mr. Chairman: As per your request at the hearings on H.R. 7247, on Wednesday, June 25, the following information is submitted:

1. Appended to this statement are relevant summaries from the last three years' reports of the Renegotiation Board, 1976, 1977 and 1978. I have underlined on these summaries the 25 cases where the Board found that one of the nation's 4500-odd defense contractors earned a profit in excess of 15% on sales in excess of $5 million. The profits over 15% during this three year period totaled $34.2 million at a time when the total amount of earned services procurement contracts approximatel $266 billion.

This would come to an average of $11.4 million per year. Assuming, then, a total suspension of Vinson-Trammell for the period October 1, 1976 through September 30, 1981, the estimated loss to the government would be less than $60 million. Costs of compliance with Vinson-Trammell during the same time, according to DOD's testimony would be at least $500 million ($100 million per year).

2. Also appended to this statement, as requested, are pages 6, 7 and 56, and the cover page from the General Accounting Office Report and Audit of Hewlett-Packard's claimed expense of compliance of $198,000.00 with Renegotiation Board requirements during 1976. Translated to the U.S. defense industry as a whole, the GAO's finding that Hewlett-Packard's costs were "considerable", supports a possible total expenditure by the defense contracting industry in excess of $200 million per year when it was complying with the Renegotiation Act.

3. Following my testimony last week, I reviewed the testimony of the Defense Department and IRS witnesses, Messrs. Dale W. Church and Philip E. Coates, respectively.

I note that DOD believes that Chairman Price's language in H.R. 7247, "making the suspension depend upon final payment", is unworkable. DOD also feels that the Senate language would not be workable (see page 2 of Mr. Church's testimony).

Correspondingly, the Treasury Department testified: (a) that the existing Act is "antiquated;" (b) using the language of Chairman Price's proposed H.R. 7247 "would be a nonproductive use of our resources" (see page 3 of Mr. Coates' testimony) and that the Senate language "may contain ambiguity that would present problems of administration if the Act were to become effective on October 1, 1981 . . ."

As you know, Mr. Church had previously stated unequivocally in a letter to the Commissioner of IRS on May 22, 1978, that "the Vinson-Trammell Act is out of date and should be repealed." I have attached a copy of Under Secretary Perry's letter as Exhibit C of this testimony.

Since both DOD and IRS have problems with both the Senate and House language, I would again suggest that the House conferees ask the Senate conferees, when considering the Defense Authorization Bill, H.R. 6974, to substitute the following simple language pursuant to my testimony on June 25:

> Shall not apply with respect to any contract or subcontract entered into after September 30, 1976, and before October 1, 1981.

Sincerely,

PAUL N. MCCLOSKEY, JR.

Enclosures.

THE UNDER SECRETARY OF DEFENSE,
Washington, D.C., May 22, 1978.

Hon. JEROME KURTZ,
Commissioner of the Internal Revenue Service,
Washington, D.C.

DEAR MR. KURTZ: With the expiration of the Renegotiation Act of 1951 on September 30, 1976, the statutory suspension of the Vinson-Trammell Act (10 U.S.C. §§ 2382 and 7300) has ended and these provisions limiting profits under certain defense contracts for the construction or manufacture of all or part of any complete new aircraft or naval vessels are once again operative.

The Department of Defense (DoD) and the Internal Revenue Service (IRS) have separate but interdependent responsibilities for administering the Act. The DoD is responsible for including the provisions required by the Act in contracts and for the receipt of reports concerning profits under such contracts upon their completion. IRS, in turn, is responsible for the determination and collection of excess profits on these contracts. The method of computing excess profit is determined by the IRS with the agreement of the DoD.

The existing Treasury Department regulations (TD 4906 and 4909) implementing the Act were first published in 1939. These regulations do not take into account changes in laws and IRS and DoD regulations that were made during the period of Vinson-Trammell Act suspension. During the past several months, we have been working with your staff to develop the additional measures that are needed for effective implementation of the Act in its current environment.

To that end we have provided your staff with proposed questions and answers addressing a number of significant problems that are not either adequately or practicably resolved in the existing Treasury regulations. These questions and answers, among other matters, address the articles that are covered, excluded, or exempted from the Act, and the circumstances that signify contract completion. A revised means of determining costs of contract performance for purposes of the Act has also been discussed between our staffs but no agreement has yet been reached. We have made available to your staff a draft revision of the form to be used by contractors in making the statutory report to the Military Departments upon contract completion. The publication of that form has been delayed pending the updating of the existing Treasury regulations.

We have, thus far, chosen to defer the transmittal of that form to the Office of Management and Budget for approval because we believe that the instructions accompanying that form concerning the computation of total contract price, cost of performing the contract, and net profit or loss should be consistent with your regulations. Such consistency will not only simplify contractor compliance with the Act but will also assure that the information contained in the reports to the Military Departments will be fully useful to the Treasury Department. It is requested that you advise us of the IRS plans and positions regarding the matters that have not been resolved in the discussions between our staffs. With that information in hand, the DoD will be able to complete the steps prerequisite to the finalization and issuance of our report form.

As these joint efforts proceed, our staffs must continue to be sensitive not only to the paperwork burden upon contractors and upon DoD and IRS but also to added costs of contractors compliance that may eventually be passed on to taxpapers in the form of higher prices of defense articles.

It has been estimated that over 1,000,000 individual contract reports will be filed annually pursuant to the Vinson-Trammell Act by more than 30,000 contractors. Our statistics on defense contract profit levels lead us to doubt that substantial amounts of excess profit will be collected under the Act. The data from our "Profit '76" study indicated an average pre-tax return on defense sales of 3.7 percent for aircraft and .6 percent for naval vessels. Moreover, the context for administration of the Vinson-Trammell Act profit limitations has changed substantially in the 43 years since enactment of that statute. During the period, comprehensive statutes governing procurement have been enacted. Among other things, these statutes require detailed disclosure of costs in connection with negotiated procurement and establishment and compliance with cost accounting standards.

These and other considerations have led us to conclude that the Vinson-Trammell Act is out of date and should be repealed. We made that recommendation to the Chairman to the Senate Committee on Governmental Affairs

in a letter dated December 21, 1977, commenting on S. 1264, the proposed "Federal Acquisition Act of 1977."

As a related matter, we have been informed of requests by General Dynamics Corp. and Litton Industries to the IRS for letter rulings exempting individual foreign military sales (FMS) contracts from application of the Vinson-Trammel Act. After analysis of the history of the Act, we have concluded that it applies only to a contract for all or part of any complete aircraft or naval vessel that is authorized to be manufactured or constructed for the Armed Forces of the United States. Accordingly, a contract for all or part of any complete aircraft or naval vessel to be supplied to a foreign government either as a foreign military sale pursuant to the authority of the Arms Export Control Act or to be supplied as military assistance under the authority of the Foreign Assistance Act of 1961, is not subject to the Vinson-Trammell Act. We understand that, in a letter ruling issued in 1964, the IRS also concluded that the profit limitation provisions of the Vinson-Trammell Act were not applicable to foreign military sales. If the IRS continues to hold that view, we suggest that it be published in a form suitable for its more general dissemination.

Sincerely,

WILLIAM J. PERRY.

1976 RENEGOTIATION BOARD ANNUAL REPORT

TABLE I.—CONTRACTORS

Transition quarter

Number, name, address	Fiscal year	Product or service	SIC No.
1. Banner Industries, Inc. (SII to Patterson Industries, Inc.), Cleveland, Ohio	1968	Missile shipping containers	3443
2. Banner Industries, Inc., Cleveland, Ohio	1968	do	3443
3. Etowah Manufacturing Co., Inc., Gadsden, Ala	1968	Fuze assemblies	3483
4. Etowah Manufacturing Co., Inc., Gadsden, Ala	1969	do	3483
5. Etowah Manufacturing Co., Inc., Gadsden, Ala	1970	do	3483
6. Etowah Manufacturing Co., Inc., Gadsden, Ala	1971	do	3483
7. Jet Electronics & Technology, Inc., Grand Rapids, Mich	1972	Gyroscopes	3811
8. Piper Industries, Inc., Memphis, Tenn	1971	Magnesium battery cans	3356
9. Piper Industries, Inc. (SII to Smalley Magnesium Co., Inc.), Memphis, Tenn	1970	do	3356
10. Continental Connector Corp., Woodside, N.Y	1972	Electronic connectors	3678
11. Continental Connector Corp., Woodside, N.Y	1973	do	3678
12. AirBorn, Inc., Addison, Tex	1973	do	3678

TABLE II.—BEFORE DETERMINATION

[In thousands of dollars, transition quarter]

Number	Renegotiable sales			Renegotiable profits[1]	Renegotiable CGS in percent			Profits as percent of—			Net worth to long-term debt
	Prime	Sub.	Total		Mat.	Direct labor	Overhead	Sales	Cap.	Net worth	
1	1,698	290	1,988	389	71.4	16.6	12.0	19.6	[4] 66.8	[4] 136.5	[2]
2	1,810	189	1,999	312	65.4	18.6	16.0	15.6	[4] 31.8	[4] 67.5	0.6
3	5,598	8	5,606	1,172	65.6	9.0	25.4	20.9	[2]	[2]	[5]
4	6,611	269	6,880	1,437	57.6	12.8	29.6	20.9	75.4	272.2	3.1
5	6,769	115	6,884	1,454	68.5	12.3	19.2	21.1	72.3	128.9	10.4
6	7,100	11	7,111	1,156	65.3	13.8	20.9	16.3	52.6	90.2	21.7
7	5,767	357	6,124	1,487	46.6	14.8	38.6	24.3	95.8	155.2	3.9
8		903	903	247	[2]	[2]	[2]	[2]	[2]	[2]	[2]
9		1,393	1,393	241	[3] 71.1	[3] 6.2	[3] 22.7	[3] 17.3	[3] 98.7	[2]	
10	277	2,340	2,617	667	41.5	31.9	26.6	25.5	48.0	56.1	
11	190	1,860	2,050	516	46.7	30.7	22.6	25.2	44.0	62.9	
12	35	1,148	1,183	311	30.2	53.7	16.1	26.3	72.7	85.2	

[1] Before adjustment for non-Federal income taxes.
[2] Not relevant or available.
[3] Ratio influenced by intercompany relationships.
[4] Commission or fee.
[5] Nominal capital, net worth, or net worth deficit.
[6] Annualized.
[7] Significant amount of capital supplied by contractor.
[8] Data not relevant because sales and profits include both agent and non-agent business.

TABLE I.—CONTRACTORS

Number, name, address	Fiscal year	Product or service	SIC No.
1. Milan Box Corp., Milan, Tenn	1974	Ammunition boxes	2441
2. ABC Food Service, Inc., El Paso, Tex	1974	Franchiser and services	7399
3. Overseas National Airways, Inc. (SII to Automated Terminal Services, Inc.), Jamaica, N.Y.	1970	Terminal operation	4583
4. Rexnord, Inc. (SII to Nordberg Manufacturing Co.), Milwaukee, Wis.	1970	Diesel engine parts	3519
5. Aerodex, Inc. (CONS), Miami, Fla	1967	Aircraft engine overhaul	3724
6. Fairchild Industries, Inc. (CONS), Germantown, Md	1967	Aircraft components	3728
7. Oso Corp., Corpus Christi, Tex	1972	Equipment leasing	7394
8. Medico Industries, Inc., Wilkes-Barre, Pa	1969	Helicopter rockets	3483
9. Medico Industries, Inc., Wilkes-Barre, Pa	1970	do	3483
10. E. P. Stephenson & Blake Whitesell (SII to All American Sales, Inc.), Muscle Shoals, Ala.	1970	Ammunition box hardware distributor	5072
11. David B. Lilly Co., Inc., Wilmington, Del	1967	Manufacturers' representative	5072
12. David B. Lilly Co., Inc., (SII to Delaware Fastener Corp.), Wilmington, Del.	1967	Bomb fin parts distributor	5072
13. David B. Lilly Co., Inc., (SII to Delaware Fastener Corp.),	1968	do	5072
14. David B. Lilly Co., Inc., (SII to Delaware Fastener Corp.), Wilmington, Del.	1969	do	5072
15. Robert M. Hadley Co., Inc., Los Angeles, Calif	1975	Electronic transformers	3677
16. Marvel Manufacturing Co., Washington, D.C	1968	Propeller balancing instrument	3811
17. Marvel Manufacturing Co., Washington, D.C	1969	do	3811
18. Windsor Manufacturing Co., Windsor, Conn	1974	Precision metal machining	3599
19. Pembroke, Inc., Egg Harbor City, N.J	1974	Coats and overcoats	2311
20. American Manufacturing Co. of Texas, Fort Worth, Tex	1966	Bomb bodies and projectiles	3483
21. American Manufacturing Co. of Texas, Fort Worth, Tex	1967	do	3483
22. American Manufacturing Co. of Texas, Fort Worth, Tex	1969	do	3483
23. American Manufacturing Co. of Texas, Fort Worth, Tex	1967	do	3483
24. Industrial Park Supply Co., Fort Worth, Tex	1969	Bomb body material distributor	5051
25. Industrial Park Supply Co., Fort Worth, Tex	1970	do	5051
26. General Industrial Corp., Fort Worth, Tex	1968	do	5051
27. General Industrial Corp., Fort Worth, Tex	1969	do	5051
28. General Industrial Corp., Fort Worth, Tex	1969	do	5051
29. General Industrial Corp., Fort Worth, Tex	1970	do	5051
30. General Industrial Corp., Fort Worth, Tex	1971	do	5051
31. Manpower, Inc., Glendale, Wis	1973	Mess attendant services	7349
32. Plastoid Corp., Long Island City, N.Y	1966	Wire and Cable	3357
33. Plastoid Corp., Long Island City, N.Y	1967	do	3357
34. Plastoid Corp., Long Island City, N.Y	1968	do	3357
35. Lawrence Engineering & Supply, Inc., Burbank, Calif	1974	Fasteners distributor and manufacturer	5072
36. Service Equipment Co., Inc., Washington, D.C	1972	Manufacturers' representative	5023
37. LaPointe Industries Inc. (SII to Northeastern Engineering, Inc.), Rockville, Conn.	1969	Frequency counters	3825

TABLE II.—BEFORE DETERMINATION

[Dollars in thousands]

Number	Renegotiable sales: Prime	Renegotiable sales: Sub.	Renegotiable sales: Total	Renegotiable profits[1]	Renegotiable CGS: Mat.	Renegotiable CGS: Direct labor	Renegotiable CGS: Overhead	Renegotiable profits as percent of—: Sales	Renegotiable profits as percent of—: Cap.	Renegotiable profits as percent of—: Net worth	Net worth to long-term debt
1	----	2,197	2,197	344	74.9	12.5	12.6	15.7	41.0	63.6	(2)
2	515	[3] 806	[3] 1,351	[3] 144	(2)	(2)	(2)	(2)	(2)	(2)	(2)
3	4,110	----	4,110	729	(2)	(2)	(2)	17.7	72.0	(2)	(2)
4	612	235	847	184	49.5	9.6	40.9	21.7	[6] 38.7	[6] 73.2	(2)
5	60,888	2,316	63,204	12,930	15.8	43.6	40.6	[3] 20.5	[3] 99.6	(2)	(2)
6	105,821	84,230	190,051	21,474	49.3	23.3	27.4	[3] 11.3	[3] 26.6	[3] 69.0	(2)
7	----	332	332	235	(2)	(2)	(2)	[3] 70.8	[3] 142.4	[3] 235.0	[3] 6.5
8	4,613	163	4,776	823	62.1	17.1	20.8	17.2	103.1	235.8	(2)
9	8,255	109	8,364	1,840	69.2	14.2	16.6	22.0	149.4	(2)	(2)
10	----	1,776	1,776	79	(2)	(2)	(2)	4.4	(2)	(2)	(2)
11	----	[4] 471	[4] 471	297	(2)	(2)	(2)	(2)	(2)	(2)	(2)
12	----	4,172	4,172	602	(2)	(2)	(2)	14.4	(2)	(2)	(2)
13	----	4,258	4,258	839	(2)	(2)	(2)	19.7	(2)	(2)	(2)
14	----	2,207	2,207	307	(2)	(2)	(2)	13.9	(2)	(2)	(2)
15	72	975	1,047	246	17.6	47.6	34.8	23.5	78.8	100.4	(2)
16	318	78	396	101	62.1	28.8	9.1	25.5	53.2	108.6	(2)
17	258	19	277	88	42.3	42.3	15.4	31.8	46.1	92.6	(2)
18	----	3,996	3,996	670	22.4	23.3	54.3	16.8	49.2	67.9	(2)
19	7,054	----	7,054	1,065	52.9	28.3	18.8	15.1	56.2	80.0	(2)
20	40,040	----	40,040	4,580	53.3	8.5	38.2	11.4	(2)	(2)	(2)
21	80,748	----	80,748	11,583	51.2	7.9	40.9	14.3	(2)	(2)	(2)
22	77,228	----	77,228	9,026	55.3	6.7	38.0	11.7	52.5	136.1	29.9
23	15,905	----	15,905	2,038	(2)	(2)	(2)	12.8	23.9	50.8	6.6
24	----	21,681	21,681	718	(2)	(2)	(2)	3.3	(2)	(2)	(2)
25	----	14,022	14,022	323	(2)	(2)	(2)	2.3	(2)	(2)	(2)
26	----	4,351	4,351	134	(2)	(2)	(2)	3.1	(2)	(2)	(2)
27	----	12,311	12,311	506	(2)	(2)	(2)	4.1	(2)	(2)	(2)
28	----	1,332	1,332	36	(2)	(2)	(2)	2.7	(2)	(2)	(2)
29	----	11,288	11,288	326	(2)	(2)	(2)	2.9	(2)	(2)	(2)
30	----	7,107	7,107	143	(2)	(2)	(2)	2.0	(2)	(2)	(2)
31	1,475	----	1,475	197	(2)	(2)	(2)	13.4	(2)	(2)	(2)
32	4,388	3,505	7,893	1,637	68.8	7.9	23.3	20.7	64.3	131.2	1.9
33	8,284	2,505	10,789	2,845	65.2	9.0	25.8	28.4	57.6	114.1	2.7
34	12,046	1,107	13,153	2,410	67.4	8.2	24.4	18.3	34.8	58.1	6.0
35	299	3,115	3,414	418	87.9	5.4	6.7	12.2	60.8	125.9	7.1
36	----	[4] 253	[4] 253	44	(2)	(2)	(2)	(2)	(2)	(2)	(2)
37	148	----	148	53	81.6	13.1	5.3	35.8	36.3	55.2	(2)

[1] Before adjustments for income taxes.
[2] Not relevant or available.
[3] Ratio influenced by intercompany relationships or by inclusion in review year of adjustments of income or cost of prior year(s).
[4] Commission or fee.
[5] Nominal capital, net worth, or net worth deficit.
[6] Partial fiscal year; data are annualized.
[7] No long-term debt.
[8] Sales and profits include both agent (section 103(g)(3) of the Act and non-agent business.

TABLE I.—CONTRACTORS

Number, name, address	Fiscal year	Product or service	SIC No.
1. U.S. Plastic Molding Corp., Melville, N.Y.	1968	Plastic parts and assemblies	3079
2. AMF Inc. (CONS), White Plains, N.Y.	1968	Bomb casings	3453
3. Mason & Hanger-Silas Mason Co., Inc., Lexington, Ky.	1968	Government plant operations	3901
4. Mason & Hanger-Silas Mason Co., Inc., Lexington, Ky.	1969	do	3901
5. Lanson Industries, Inc., Cullman, Ala.	1971	Bomb dispensers and containers	3453
6. Continental Connector Corp., Woodside, N.Y.	1974	Electronic connectors	3678
7. Southern Fabricating Company, Inc., Sheffield, Ala.	1966	Ammunition box hardware	3429
8. Southern Fabricating Company, Inc., Sheffield, Ala.	1967	Ammunition box hardware	3429
9. Southern Fabricating Company, Inc., Sheffield, Ala.	1968	do	3429
10. Estate of Gillmore M. Perry, Chevy Chase, Md.	1969	Manufacturers' representative	5021
11. Estate of Gillmore M. Perry, Chevy Chase, Md.	1970	do	5021
12. Estate of Gillmore M. Perry, Chevy Chase, Md.	1971	do	5021
13. Estate of Gillmore M. Perry, Chevy Chase, Md.	1972	do	5021
14. Estate of Gillmore M. Perry, Chevy Chase, Md.	1974	do	5021
15. Estate of Gillmore M. Perry, Chevy Chase, Md.	1975	do	5021
16. Vinnell Corp., Alhambra, Calif.	1972	Logistical services	7369
17. A. J. Industries, Inc. (CONS), Los Angeles, Calif.	1972	Fire bombs and airborne fuel systems	3483
18. Stehna, Inc. (SII to 1960 Delaware Corp. of same name.), Stamford, Conn.	1967	Telecommunication equipment	3662
19. Earle M. Jorgensen Co., Los Angeles, Calif.	1975	Forged ship shaftings	3462
20. Howmet Corp. (SII to 1969 Delaware Corp. of same name.), Greenwich, Conn.	1971	Super alloy castings	3369
21. EDG, Inc. (formerly Edgington Oil Co.), Long Beach, Calif.	1974	Jet fuel	2911
22. EDG, Inc. (formerly Edgington Oil Co.), Long Beach, Calif.	1976	do	2911
23. FMC Corp (CONS), Chicago, Ill.	1971	Armored tracked vehicles	3795
24. Hercules, Inc, Wilmington, Del.	1970	Propellants, rocket motors, and explosives.	3901
25. DeLong Corp. (New York) (SII to DeLong Corp.) (Delaware), New York, N.Y.	1969	Pier barges and personnel supply	1629
26. Poloron Products, Inc. (CONS), Harrison, N.Y.	1969	Bomb fins	3483
27. Oso Corp., Corpus Christi, Tex.	1973	Equipment leasing	7394
28. ABC Management Services, Inc., El Paso, Tex.	1974	Food and mess attendant services	7369
29. ESL, Inc., Sunnyvale, Calif.	1974	Reconnaissance and communication systems.	3662
30. OEA, Inc. (CONS), Des Plaines, Ill.	1970	Emergency escape system devices	3728
31. OEA, Inc. (CONS), Des Plaines, Ill.	1971	do	3728
32. OEA, Inc. (CONS), Des Plaines, Ill.	1972	do	3728
33. OEA, Inc. (CONS), Des Plaines, Ill.	1973	do	3728
34. Norman S. Fink Engineering Co., d.b.a. Norman Engineering Co., Los Angeles, Calif.	1974	Architectural and engineering service	8911
35. Tan-El Enterprises, Inc., New York, N.Y.	1971	Textile converter	5133
36. So-Sew Styles, Inc., Centre, Ala.	1973	Field coats	2329
37. MB Associates, San Ramon, Calif.	1973	Chaff and chaff dispenser systems	3728

TABLE II.—BEFORE DETERMINATION

[Dollars in thousands]

Number	Renegotiable sales: Prime	Renegotiable sales: Sub.	Renegotiable sales: Total	Renegotiable profits[1]	Renegotiable CGS in percent: Mat.	Renegotiable CGS in percent: Direct labor	Renegotiable CGS in percent: Overhead	Renegotiable profits as percent of—: Sales	Renegotiable profits as percent of—: Cap.	Renegotiable profits as percent of—: Net worth	Net worth to long-term debt
1	772	445	1,217	232	50.9	17.9	31.2	27.3	*84.9	185.8	1.6
2	112,687	24,746	137,443	20,963	05.0	13.1	21.9	15.3	48.3	120.1	1.9
3	158,008	.....	158,008	4,005	(?)	(?)	(?)	2.6	(?)	(?)	(?)
4	143,284	.....	143,284	3,391	(?)	(?)	(?)	2.4	(?)	(?)	(?)
5	6,758	.....	6,758	2,003	63.6	16.5	19.9	*22.9	174.8	(?)	(?)
6	234	2,045	2,279	495	48.8	29.5	21.7	21.7	38.5	57.4	4.3
7	.....	1,408	1,408	510	53.9	16.9	29.2	36.2	74.7	320.6	(?)
8	.....	5,516	5,516	2,466	57.9	21.2	20.9	44.7	198.1	(?)	(?)
9	.....	4,864	4,864	2,143	48.9	30.4	20.7	44.1	118.7	(?)	(?)
10	.....	*424	*424	342	(?)	(?)	(?)	(?)	(?)	(?)	(?)
11	.....	*304	*304	240	(?)	(?)	(?)	(?)	(?)	(?)	(?)
12	.....	*231	*231	157	(?)	(?)	(?)	(?)	(?)	(?)	(?)
13	.....	*322	*322	249	(?)	(?)	(?)	(?)	(?)	(?)	(?)
14	.....	*220	*220	150	(?)	(?)	(?)	(?)	(?)	(?)	(?)
15	.....	*360	*360	271	(?)	(?)	(?)	(?)	(?)	(?)	(?)
16	15,796	.....	15,796	2,532	19.1	71.9	9.0	16.0	(?)	(?)	(?)
17	11,097	986	12,083	2,284	65.3	9.3	25.4	18.9	58.4	92.0	1.6
18	8,549	867	9,416	1,957	15.3	39.1	45.6	20.8	47.0	73.2	4.6
19	.....	4,397	4,397	712	49.5	5.3	45.2	16.2	63.9	110.6	4.6
20	.....	34,640	34,640	5,970	46.1	16.0	43.9	17.2	29.3	116.9	.3
21	9,733	249	9,982	2,273	80.2	2.1	8.7	22.8	64.6	144.3	(?)
22	13,081	4,318	17,399	4,100	89.2	2.2	8.6	23.6	40.1	68.0	2.6
23	132,910	4,506	137,316	15,707	43.9	21.6	34.5	*11.4	*37.0	*64.5	(?)
24	132,323	79,929	212,752	17,819	(?)	(?)	(?)	*8.9	(?)	(?)	(?)
25	43,910	.....	43,910	8,513	(?)	(?)	(?)	19.4	(?)	(?)	(?)
26	18,855	.....	18,855	2,580	68.1	16.9	15.0	13.7	41.4	96.4	12.6
27	.....	322	322	231	(?)	(?)	(?)	*65.6	*148.6	*226.9	(?)
28	7,626	.....	7,626	997	(?)	(?)	(?)	7.8	(?)	(?)	(?)
29	11,781	3,840	15,621	1,543	20.0	31.1	48.9	9.9	20.5	58.1	(?)
30	811	5,010	5,821	2,105	44.6	32.9	22.5	36.2	66.1	100.0	(?)
31	1,388	3,825	5,213	1,099	40.2	32.7	27.1	21.1	27.2	37.4	(?)
32	3,669	6,438	9,446	1,907	48.8	26.3	24.9	20.2	25.3	38.7	(?)
33	2,880	7,386	10,266	2,083	42.3	29.2	28.5	20.3	26.2	39.1	(?)
34	6,111	449	6,560	656	80.0	12.3	7.7	9.9	(?)	(?)	(?)
35	1,811	6,910	8,721	656	(?)	(?)	(?)	7.5	38.5	32.3	(?)
36	2,859	4	2,859	642	(?)	(?)	(?)	22.5	65.1	178.1	(?)
37	10,150	.....	10,154	1,317	60.2	14.7	25.1	13.0	40.7	50.3	210.6

Footnotes at end of table III.

Mr. STRATTON. It may be the Renegotiation Board was the one that was unproductive rather than the defense industry.

Mr. DAN DANIEL. I do not have any questions. I am in general agreement with what the witness has had to say.

I want to commend this gentleman for his statement and thank him for making it a part of the record.

As I see it, one of the major problems we have in this country is productivity, or the absence of productivity. Now, capital formation is a basic problem, and those profits are essential if we are going to have jobs in this country and taxes. The capital formation is derived from profits.

I think that, unless we maintain the incentive in this country that we have had over the years through the profit-motivated system, we are going to have a very difficult time competing with other industrial nations around the world.

I commend the gentleman for his statement.

Mr. MCCLOSKEY. Thank you.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

Mr. STRATTON. Mr. Badham, have you any questions?

Mr. ROBERT DANIEL. No questions.

Mr. STRATTON. Mr. Badham, have you any questions?

Mr. BADHAM. Yes.

I want to thank the witness for his statement.

I would like to clear up perhaps a misunderstanding.

Weren't you basically saying, Mr. McCloskey, that there is a great difference between the U.S. Government requiring through inspections, the contractor having bid and won a contract and performing to the specifications in building what is specified in the case of a ship, as opposed to keeping records that are totally unrelated to the construction, the bidding and the specifications.

Once you bid and are awarded a contract at a price, if you perform according to specifications, you should be paid without any additional paperwork. Isn't that substantially what you were saying the complaint was?

Mr. MCCLOSKEY. You have made the distinction better than I did. It is between the inspection process and the recordkeeping process.

Mr. BADHAM. Inspection has to do with the actual physical construction of the ship, or whatever it is you will build.

I have no further comments. I commend the gentleman for his testimony.

Mr. MCCLOSKEY. Thank you.

Mr. BADHAM. Thank you, Mr. Chairman.

Mr. STRATTON. Mr. Beard.

Mr. BEARD. I thank the Chairman.

I commend the gentleman for a fine statement, a very perceptive statement, on a particular issue that has to be dealt with in a very thorough way. I am not totally familiar with the entire procedure of the Vinson-Trammell Act.

Is it the gentleman's understanding that the Internal Revenue Service and the Department of Defense have both come out stating that this particular piece of legislation of the bill should be eliminated or taken off the books? Is that your understanding?

Mr. MCCLOSKEY. No. The problem is that it appears the Internal Revenue Service and the Defense Department, by having a 1934 act suddenly take effect in 1976, have not known what to do. They are caught in a box.

Any regulations they put into effect now will apply for the last 3½ years and the next 1½ years. They have clearly been unable to devise regulations that will not be outrageous.

They have chosen to do nothing. The problem that that raises is this. If some citizen should bring a lawsuit saying that the Government is not enforcing the law, that citizen would be entitled and the court would probably issue a writ to enforce the act.

Since the administration has been unable to solve the situation, it is now up to the Congress to do so. You have before you a question of how to handle the last 3½ and the next 1¼ years. I am urging that you go on the side of giving industry a break, rather than guard against all possible loss of profit.

In the last 3 years of the Renegotiation Board, there were only 25 cases where a contractor had made over a 15-percent profit. When you consider next year, the careful amending of the law, the only real likelihood is adopting the 15-percent limit.

If you adopt the 15 percent limit, the question is what about the last 5 years. The problem is the honorable, cautious contractors, not knowing whether you are going to amend the law or not, not knowing whether Vinson-Trammell is going to be applied for the past 5 years and under what regulations will not know whether or not to maintain records.

If the maintenance of those records costs the companies $250 million, then that cost will ultimately be paid for by the taxpayer.

There is no record in the past 3 years that the taxpayer got any benefit at all out of the Renegotiation Board.

Mr. BEARD. I arrived a little late and missed part of your statement, so maybe you made this observation. We are not just dealing or talking about the big, international corporations or construction corporations. It seems to me this bill would have an effect on your small subcontractors, your small businessmen, and those who do not have the wherewithal to take care of all the administrative, legal, and accounting costs. Is there not something where final payment would fall within the act until final payment has been made? This creates total havoc with the small businessman.

Mr. MCCLOSKEY. That is the chairman's language in his bill. Payment would have to be received in the next 15 months for the moratorium to apply to the individual involved.

One of the reasons we terminated the Renegotiation Board is we did not find the Board assessing McDonnell Douglas or Lockheed in the last few years. They were getting overcoat manufacturers and wood pallet manufacturers. If you look at the 30 companies each year they assessed, they were smaller business people.

You have this monumental imposition of recordkeeping on 4,500 businesses. Yet the only people the Renegotiation Board got essentially were the smallest businesses, people in North Carolina making overcoats or wood pallets.

Mr. BEARD. It is at the point where a significant percentage of the small suppliers would say forget it when it comes around to bidding or to dealing with Government contracts. I have seen that in the past in other areas.

Mr. MCCLOSKEY. In my area, which is Silicon Valley—and I cited this on page 3—one subcontractor, which is a conscientious one, said if they complied with the House language, it would cost them $10 million to $15 million, and the Senate language would be $10 million.

That is why I proposed the alternate language, which makes it very clear that a sizable group of these contractors are removed from obligation over a 5-year period.

Mr. DAN DANIEL. Will you yield?

Mr. BEARD. Yes.

Mr. DAN DANIEL. I think the reason they hit the smaller contractors rather than the larger ones is the fact that the small contractor simply does not have the resources in order to comply with the massive regulations imposed upon him by the Federal Government.

Would that be a fair statement?

Mr. MCCLOSKEY. That is correct. I can give you an example from my own law practice. I started out as a single lawyer. We finally built up to 10 lawyers. We now have law firms that get up to 40 or 50. Until

you have that many people, you cannot afford the accounting services that are required just in the ordinary, day-to-day recordkeeping.

You have to be big in order that the net percentage of your overhead for legal and accounting drops to a lower percentage. We are driving small businesses out of existence by making it impossible for anybody to operate them. As a life-long attorney, I quite honestly think we have too many lawyers in this country. We are creating too many laws and regulations.

Mr. DAN DANIEL. Thank you.

Mr. STRATTON. I think perhaps the chairman is more guilty on this score than anyone else; but I think it is clear that, if we go into this whole subject, we could be here for the next couple of months. What we really need to address is the question of whether there should be or should not be a waiver, and what a waiver would do, and what the implications of such a waiver would be, particularly in the event, as the chairman has indicated, that there might be a decision on the part of this committee that some sort of limitation was desirable.

This is particularly with respect to your testimony, Mr. McCloskey.

Now, suppose legislation was passed in the next session to restore some kind of profit limitation. Then how would you propose to enforce this legislation under the wording that you proposed, on the final page of your statement, on contracts entered into before October 1, 1981, but which might not be completed for 10 or 15 years? Could you comment on that?

Mr. MCCLOSKEY. Obviously those contracts would be free from any potential assessment of excess profits over 15 percent. I defend that solely on the basis of the very minor number of contracts that have ever shown excess profit. I do not think you can find a big contractor in this country who has made a profit of over 15 percent on aircraft or shipping in the last 5 years.

Mr. STRATTON. It is fair to say, to sum up your position, that you not only are in favor of a waiver, so this subcommittee can examine the matter in greater detail, but your position is that our contractors in the defense industry are doing a fair job and are not getting excessive profits, and we should, therefore, drop the whole idea of any kind of limitation whatsoever.

Mr. MCCLOSKEY. I would qualify it this way. I would say that the record of the last 3 years of the Renegotiation Board demonstrates that the number of excess profits are so few that the Renegotiation Board or Vinson-Trammell cannot be justified because the overhead cost is $250 million a year, and it is not worth the money.

Mr. STRATTON. I do not think you are saying anything different from what I said, except maybe you are not making it quite as obvious. What you are saying is that you believe there should not be any limitation whatsoever; that if you just leave the contractors alone, they are good, clean, honest American people, and they will not make more than 15 percent.

Mr. MCCLOSKEY. The records indicate that so few of them have made over 15 percent that the topheavy weight of regulation is there.

Mr. STRATTON. Very well. That is your position. It is the position of a number of people in the House. This is not just addressed to the matter of the waiver, but it is the whole idea of any limitation.

Mr. BEARD. Will you yield?

Mr. STRATTON. Yes.

Mr. BEARD. We are not throwing our eggs in one basket. Aren't there tons of regulations as far as procurement regulations and restrictions here? We have in effect many, many regulations. This is not the only regulation, the Vinson-Trammell Act. I think there are plenty of safeguards.

The main thing is they have to be enforced by good oversight hearings by this committee and by the Appropriations Committee.

Mr. STRATTON. There must be something in this or there would not have been so many long-time efforts to remove both the Renegotiation Board and now Vinson-Trammell. We have a vote on the floor at this time.

Mr. MCCLOSKEY. Yes.

Mr. STRATTON. This concerns the Senate amendment on draft registration.

The subcommittee will stand in recess for 10 minutes.

[Whereupon, a short recess was taken.]

Mr. STRATTON. The subcommittee is back in order at this time.

I have two specific questions for you, Mr. McCloskey.

Mr. MCCLOSKEY. Yes.

Mr. STRATTON. They are directed to the specific point we are supposed to be considering. In light of your response to my earlier question that there would be really nothing we could do about limiting the excessive profits under your language, which would be on contracts that might have been entered into before October 1, 1981, but might take 10 or 15 years to complete, do you have any way of estimating how much risk the Government would be running or how much the Government might lose in terms of a waiver of the character that is proposed by the chairman's bill and by your language?

Mr. MCCLOSKEY. I can supply this for the record, Mr. Chairman.

The way I would do it is to go back to the last 5 years of the reports of the Renegotiation Board to find out precisely what it was in those 5 years that the Renegotiation Board would cover.

My recollection is that when we looked at the Renegotiation Board, we found that it was a net of less than $10 million per year that the Government was actually recovering. I think that would be the only valid way that I could answer your question.

I would be glad to do that because I think those facts should be in front of the committee when it makes that decision. (See p. 11.)

Mr. STRATTON. Thank you.

There is one other point. Would you agree that, if we were to effect a moratorium by legislation, it would therefore require positive legislation to rescind the moratorium?

Mr. MCCLOSKEY. I think so. I have not examined that question, but I would think that would be the case.

What I am arguing for, Mr. Chairman, is that business ought to have certainty. Certainty can only be granted by giving a clear moratorium. If you were going to go back after the fact and look at excessive profits earned during those 5 years, it would seem to me you would need specific legislation to do it.

I would wonder about the constitutionality of it in view of the contract clause, as to the fifth amendment. It would seem to me it

would take specific legislation. I would be skeptical of it being effective once we had enacted by law a statement that contracts in the 5-year period were not subject to excess profits.

I think during the 15 months between now and October 1, 1981, we might be powerless to recapture it, if you adopt my language.

Mr. STRATTON. One of the things that troubles me is that we might have difficulty if we felt there was some limitation required, and we might have difficulty having enacted the moratorium to get any kind of support for reinstituting some kind of limitation.

The only legislation that comes to my mind is the protocol feature of the SALT II Treaty, which is now fortunately in limbo. That was to expire on a particular date. I have forgotten the date. I think it was January 1, 1981.

There was concern that having the Soviets, having achieved a limitation on our utilization of cruise missiles and the other things provided by the protocol, there might be great pressure built up to continue the protocol after the expiration date.

I think one of the Senate reservations voted on in the committee, at least, was to require an active vote to keep it in operation. In other words, this was an attempt to make sure that once the period had elapsed, there was not going to be great difficulty in returning to the status quo.

I do not know whether that would apply in the legislation or not. I wondered whether you had any observation.

Mr. MCCLOSKEY. It seems to me what you are doing is putting a stamp on what the administration is doing anyway. They obviously cannot come up with regulations or they would have done so.

You are faced with a de facto moratorium of some sort. It is just a question of what form the moratorium will take. By the terms of the proposed act, you are only giving a 5-year moratorium.

Mr. STRATTON. Mr. Hopkins, have you any questions?

Mr. HOPKINS. Is this legislation wired and, if so, how? And if not, how do you respond to the charge made?

Mr. MCCLOSKEY. Mr. Minish was supposed to testify before me. I thought the debate between me and Mr. Minish would be before the committee.

My record as a defender of the Defense Establishment is not all that good. I do not think I have been accused of being wired into the defense industry as a primary advocate.

The issue here is essentially whether the paperwork serves any benefit. I think that if Joe testifies before the committee, he will say that this industry is a group of thieves.

If they are a group of thieves, and if they have been stealing the Government blind, the Renegotiation Board in the last 3 years of its existence would certainly have recovered excess profits. In many cases, the Board could recover 8 percent on defense contracts, as opposed to 5 percent in the company's ordinary course of business. It was reviewing the records of the Renegotiation Board that led me to argue for its abolition, not as a friend of the defense industry, but because of the fact that a Government agency costing $250 million a year was recovering perhaps a net of $3.5 or $5 or $7 million a year.

When we search for ways to make U.S. industry productive again and credible, the removal of excess paperwork would seem to be the

No. 1 priority. If Joe Minish says these guys are thieves, why wasn't the Renegotiation Board able to recover more money over the last 5 years of its existence?

The record does not indicate that they have made excess profits beyond 15 percent. In 3 years, we found 25 instances.

You may say that the taxpayers insist we not let them run away with our money. If the taxpayer knows we are spending $250 million to get $7 million, it seems an undue expenditure.

I think that the record ought to speak for itself. It is not a debate on Joe's part that says this is a group of thieves and we must restrict them. But the question is: What are the facts? What do the facts show?

The facts do not show excess profits. I can think of companies in my district that do not want to deal with the Government, who would prefer not. These are the better companies, the competitively successful companies. They do not want to bid on a Government contract because the excess cost of the paperwork will cut into their profit margin. They would prefer to do business elsewhere.

The taxpayer loses the benefit of the best companies in America serving the Government. It is a balance between the two.

I think the rhetoric that we are wired or they are thieves ought to rest on the basis of what the facts have actually been. I do not want to argue beyond that. I think the last 5 years of the Renegotiation Board show we had an ineffective agency created in wartime to accomplish a specific task, which is no longer necessary.

I would cheerfully accept the taxpayers' complaint to say, let the defense industry off the hook. Off the hook for what? What does the record show they actually did in the last 5 years? In this case, I cannot find that much benefit.

Mr. HOPKINS. Thank you.

Mr. MCCLOSKEY. Yes.

Mr. STRATTON. Thank you very much, Mr. McCloskey.

Have you any further questions?

Mr. HOPKINS. No.

Mr. ROBERT DANIEL. I have a question.

Mr. STRATTON. Excuse me. Mr. Patterson is in the room and Mr. Minish is supposed to be here at 11:30. So we do want to try to move this thing along.

Mr. ROBERT DANIEL. I certainly will not prolong it because we have such a long list of witnesses.

I just want to say that the logic of this and the arithmetic from the gentleman from California in the testimony he presented seem pretty persuasive to me at this point.

Thank you.

Mr. MCCLOSKEY. Thank you.

Mr. STRATTON. Thank you very much, Mr. McCloskey.

Mr. MCCLOSKEY. Is my full statement in the record? I would like that entered into the record, and I will submit on Friday or before the facts that the chairman asked for with respect to the 5 years of the Renegotiation Board.

Mr. STRATTON. Without objection, your full statement has been included in the record.

We appreciate your submitting the other material. Thank you very much.

Mr. McCLOSKEY. Thank you.

Mr. STRATTON. Our next witness is Congressman Jerry M. Patterson from California.

We would welcome your statement.

STATEMENT OF HON. JERRY M. PATTERSON, A REPRESENTATIVE FROM CALIFORNIA

Mr. PATTERSON. Thank you, Mr. Chairman and members of the subcommittee.

It is a pleasure to be here this morning and to share my views on the act. I think the subcommittee has a rather difficult job, as is shown by the prior witness's testimony, that of Mr. McCloskey, and coupled with things like the Washington Post article which was in this morning's paper. The matter simply that is not so clear is whether or not Vinson-Trammell should be suspended for 1 year.

I know that is the bill that is before the subcommittee. That is perhaps based upon the fact that it is an impossible act to implement in its present form.

The alternative of the outright repeal is perhaps a ripoff to the taxpayer, or it could be. So suspension seems to be kind of doing something to move it along at least for another year.

Mr. Chairman, Vinson-Trammell has been pending congressional action since 1976. Unfortunately, it will not evaporate into the atmosphere. If a suspension or extension is given for 1 year, it will remain for Congress to act upon it in some responsible fashion.

Your subcommittee deserves credit for taking the initiative to bring the matter to the attention of the public at this time.

The subcommittee has requested my comments on H.R. 7247. This bill will delay the day of reckoning, and it forces temporarily exempt contractors to contend with the troublesome uncertainty and confusion of reporting under the provisions of the 1934 act, which everyone agrees is unenforceable.

For contractors and subcontractors not included under the bill's waiver criteria, H.R. 7247 offers no relief. They would still have to compile the costly and voluminous reports required by the 1934 act, unless some change is made in the bill as suggested by Mr. McCloskey.

I believe it is time for us to be decisive on Vinson-Trammell. The problem is not so overwhelming that this Congress cannot arrive at a workable solution.

I introduced H.R. 5433 in September 1979. It provides public policymakers and the defense contracting industry with a solution that is reasonable and, I believe, equitable. H.R. 7247 waives the application of the Vinson-Trammell Act for certain contracts, whereas, my bill, H.R. 5433, repeals the onerous provisions of the 1934 act retroactively to October 1976 when VTA was reactivated after the demise of the Renegotiation Act.

The IRS would be spared under my bill from the task of implementing the 1934 act, thus, eliminating the need for that agency to

hire 1,500 additional employees at a cost of $120 million to the taxpayer.

The substitute approach for profit monitoring contained in H.R. 5433 would apply only to large—that is, those in excess of $5 million—contracts, which are awarded by DOD, on a noncompetitive basis. What this means is about 7 percent of all awarded DOD contracts would be reviewed in the required report.

However, while that is a small number, and 93 percent would not be subject to the act, the 7 percent represents 57 percent of the defense contracting budget, which would be subject to the Vinson-Trammell reporting under H.R. 5433.

Small businesses and most subcontractors would be completely exempt. Less than 1 percent of DOD's noncompetitive contracts exceeding $5 million are awarded to small businesses.

Efficiency and outstanding contractor performance will be encouraged. Contractors will be able to keep any amounts earned under the performance incentive or value engineering provisions of their contracts with DOD. DOD will be able to implement the proposed program efficiently at low cost to the Government and to the defense contractors.

The new program, if enacted, would be effective prospectively, 4 months after the date of enactment. The program under the bill, as I introduced, would sunset after 5 years.

Mr. Chairman and members of the committee, the Defense Department, in response to my inquiries, states that neither the Truth in Negotiations Act nor the Cost Accounting Standards Act "forces a contractor to exercise the same measure of reasonableness in estimating contracting costs as would be applied in a competitive situation."

The Defense Department concluded in this letter—and this is a quote—

> In those situations where we cannot realistically negotiate a fair price at the outset, we need a statutory profit limitation to recapture any excess profit realized when the contract is completed.

This is a crucial point since industry argues that current law sufficiently protects public interests. Under existing law, the Department does not have the right to audit final contractor cost data. Truth in negotiations gives the Department access to data to determine the completeness, currency, and accuracy of contractor cost estimates.

With a Defense Department procurement budget for fiscal year 1981 exceeding $40 billion, we need a statutory safeguard authorizing DOD to monitor large, noncompetitive contracts. That is precisely what the bill that I suggest would do.

This type of safeguard need not and should not resemble the burdensome requirements of renegotiation, and I supported the repeal of that before it became popular, before it passed. This was along with Mr. McCloskey.

Congress put that to rest last year. A modified Vinson-Trammell Act need not apply to small businesses or to competitively awarded contracts. The new program should also, as H.R. 5433 proposes, sunset as of a date certain so that Congress can reconsider its merits and provide flexibility in dealing with changes in defense procurement.

In conclusion, I restate my position that H.R. 7247 is an inadequate

response to the problems created by the 1934 Vinson-Trammell Act. On the other hand, H.R. 5433, which has been pending before Congress for 9 months—and I testified before the Senate on this bill—offers permanent relief to small businesses and to contractors of any size who obtain DOD contracts on a competitive basis.

It is a workable, responsible solution to an issue of great public and private concern.

I have attached, Mr. Chairman, for further reference my testimony of February 25 of this year before Senator Morgan's Armed Services Subcommittee detailing the provisions of my bill. I ask that be included in the record following my statement.

Thank you for allowing me to present my views.

Mr. STRATTON. Without objection, it may be included.

WRITTEN STATEMENT OF HON. JERRY M. PATTERSON

Mr. Chairman and members of the subcommittee, I appreciate your invitation to testify at this hearing concerning the Vinson-Trammell Act of 1934 and hope that this testimony will be helpful to you as you determine what revisions to the act may be most appropriate.

The Renegotiation Board's contract review powers expired on September 30, 1976, and Congress abolished the board by refusing to fund it beyond March 31, 1979. As a result, Vinson-Trammell became effective. If Congress does not amend the existing act before April 15, which is less than 2 months away, defense contractors will be required to file with the IRS.

The IRS' proposed regulations, reflecting the requirements of the 1934 act, will subject almost all DOD contractors and subcontractors of naval vessels and military aircraft to reviews for every income taxable year beginning after October 1, 1976. These proposed regulations, appearing in the October 26, 1979, Federal Register (pp. 61611-61681), refer to aircraft and shipbuilding contracts and subcontracts in excess of $10,000. They will cover contracts for the "construction or manufacture of all or a part" of a new complete naval vessel or military aircraft. A "portion" as defined under the proposed rules constitutes:

> Any material or article that forms part of a complete naval vessel or military aircraft and that has been furnished under a mutual understanding that it is to form such a part.

Every contractor and subcontractor will be required to make available for inspection and audit at all times by DOD its manufacturing plants and books of its "plants, affiliates and subdivisions."

The urgency of bringing Vinson-Trammell up to date can best be illustrated by describing the impact of imposing 1934 contracting requirements on defense procurement in the 1980s.

(1) IRS would be responsible for implementing the existing Vinson-Trammell Act. In order to fulfill this responsibility, IRS must hire almost 1,500 new employees at a cost of roughly $35 million.

(2) Under the 1934 act, covering aircraft and shipbuilding contracts in excess of $10,000, more than 10,000 additional defense contract audit reports would be filed every year.

(3) The $10,000 floor will subject small businesses to review under Vinson-Trammell. The effect will be to force these businesses into a paperwork jungle.

(4) Annual costs of administration and compliance could easily exceed $120 million.

(5) The requirements of the 1934 act apply to domestic as well as foreign subcontractors. McDonnell-Douglas' F-15 contract involves some assembly and parts manufactured in Japan: Canada supplies some of the parts under Lockheed's P-3 (Navy patrol aircraft) contract; and the C-130 and C-141 (Air Force cargo transfer) projects involve some foreign co-production in Belgium and Holland.

Foreign co-production is not exempt under the 1934 Vinson-Trammell Act. Therefore, foreign subcontractors will be required to accept the terms of the Vinson-Trammell Act—including inspection and audit of their records by the U.S. Government—before the subcontract can be awarded.

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Resuscitating Vinson-Trammell in its present form cannot be justified. As an alternative to the 1934 act, I draw your attention to H.R. 5433. The thrust of this proposal is to repeal unworkable provisions of the existing act and to replace those provisions with a system that can be effective and which will exempt small contractors.

Let me outline briefly the major provisions of H.R. 5433.

(1) How would H.R. 5433 amend the 10 percent and 12 percent profit limitations on shipbuilding and aircraft contracts in excess of $10,000?

H.R. 5433 repeals those provisions of Vinson-Trammell. In place of those standards established in 1934, the bill sets a 15-percent profit ceiling on noncompetitive Defense Department contracts and noncompetitive first-tier subcontracts in excess of $5 million. Sixty-five (65%) percent of Defense Department contracts are awarded on a noncompetitive basis. That represents about 75 percent of defense contracting dollars. If H.R. 5433 is enacted, 7 percent of our defense contacts will be subject to Vinson-Trammell, representing about 57 percent of the defense contracting budget. (See section 2(b)(1) and (2).) Section 2(b)(3) clarifies that a noncompetitive contract is one the price of which is not based upon adequate price competition, catalogue or market prices of commercial items sold in substantial quantities to the general public or prices set by law or regulation. The definitions of "adequate price competition" and "commercial articles" are contained in 10 U.S.C. 2306(f) and in Defense Acquisition Regulations (DAR) 3.807.7.

(2) Will the profit policy of H.R. 5433 be imposed retroactively?

The new 15-percent ceiling will not be imposed retroactively. Section 4 of H.R. 5433 repeals the 10 percent Vinson-Trammell limit for shipbuilding contracts effective October 1, 1976, the date on which the Renegotiation Board's authority to review new contracts expired. Section 5 would repeal the 12-percent Vinson-Trammell aircraft contract profit ceiling also as of October 1, 1976. However, according to section 5(b), the excess profit policy of H.R. 5433 "shall apply only to contracts and subcontracts entered into from the close of 120 days after the date of enactment of this act until the close of 60 months after the date of such enactment." This language states plainly that the profit limitation program will not apply retroactively. It will be prospective and will sunset at the end of 5 years.

(3) Will H.R. 5433 penalize efficient or outstanding performance by a contractor?

H.R. 5433 provides at section 2(b)(4)(A) and (B) that deductions from profits in excess of 15 percent shall be allowed for amounts earned under performance incentive and value engineering provisions and "other similar provisions for sharing of cost savings results from changes in means, methods, and materials for performance of work." These provisions grant contractors ample opportunity to be rewarded for efficiency and outstanding performance. The amounts earned can be found on the contract form.

Example.

Computing excess profit

Contract price	$6,000,000
Profit	1,200,000
15 percent equals (allowable)	900,000
Excess, equal	300,000
Assume that: PI plus VE equals (allowable deduction)	200,000
Excess profit	100,000

(4) Some contractors argue that the Vinson-Trammell Act was enacted as a consequence of some corporations' greed in World War I when the Government had neither the time nor the staff to investigate proposed costs of performance. They claim that through truth in negotiations, cost accounting standards, and the mandatory cost principles in the Defense Acquisition Regulations (DAR), DOD's ability to negotiate a reasonable cost is quite good. Therefore, they conclude that a simple repeal of Vinson-Trammell makes more sense.

In his September 25, 1979, response to one of my inquiries, the Deputy Under Secretary for Acquisition Policy of the Defense Department said:

> Your letter notes that the type of legislation that you propose has been opposed on the ground that existing procurement safeguards make unneces-

sary any excess profit limitations on noncompetitive defense contracts. Laws such as the Truth-in-Negotiations Act (10 U.S.C. 2306(f)) and the Cost Accounting Standards Act (50 U.S.C. app. 2168) help the Government substantially to secure fair and reasonable prices in noncompetitive procurements. These statutory tools, however, will not prevent the occurrence of unintended excessive profits.

A DOD letter to the Office of Management and Budget dated July 5, 1979, regarding Vinson-Trammell states:

A statutory profit limitation is not needed for national defense contracts, the price of which is based upon adequate price competition, catalog or market prices of commercial items sold in substantial quantities to the general public, or prices set by law or regulation. A statutory profit limitation is needed, however, to deal with situations where a contractor or subcontractor exploits its sole source position to demand much higher prices than would be sought in a commercial environment. Often these sole source prices are inflated by estimating on a "worst case" basis instead of assuming reasonable economy and efficiency, or by including cost contingencies for highly unlikely events such as catastrophic test failures or dramatic business downturns.

Existing statutory tools are not designed to prevent an unreasonable profit in these sole source situations. The contractor or subcontractor will have complied with the Truth in Negotiations Act (10 U.S.C. 2306(f)) in disclosing and certifying the proposed cost and in presenting such cost in conformity with the Cost Accounting Standards Act (50 U.S.C. app. 2168). Nothing in these laws forces a contractor to exercise the same measure of reasonableness in estimating as would be applied in a competitive situation. In those situations where we cannot realistically negotiate a fair price at the outset, we need a statutory profit limitation to recapture any excess profit realized when the contract is completed.

Additionally, the Defense Department wrote me on December 21, 1979, saying:

We believe the functions of the GAO and the DCAA would not prevent excessive profits from accruing to a contractor. Negotiated contract prices are based on a contractor's cost or pricing data and the judgmental factors applied in projecting from the data to the estimated contract cost. Cost or pricing data, being factual, can be audited by agencies such as GAO and DCAA. The judgmental factors, however, are not auditable and must be resolved through negotiation. Existing laws would not preclude a situation where a contractor would exploit a sole source marketing position to demand higher prices or profits than would be sought in a competitive environment, or where poor or hurried negotiations would result in a contractor realizing an excessive profit.

(5) Contractors raise the following question:

If typical profits on cost-type contracts range from 6½ percent–7½ percent and from 12 percent–13 percent for firm fixed-price contracts then why should a 15 percent or any other ceiling be imposed?

The answer is that there is a need to capture unconscionable profits from sole-source providers in atypical cases. Furthermore, the 15 percent ceiling is reasonable and will give contractors an incentive to do business with the Government.

Also, with the setting of a $5 million floor, we will be looking at 7 percent of DOD non-competitive contracts, focusing attention on the largest awards.

In March 1979 the House General Oversight and Renegotiation Subcommittee held hearings on the Renegotiation Act at which time Vinson-Trammell reform was also discussed. My distinguished colleague and fellow Californian, Congressman Pete McCloskey, succinctly stated the issue when he remarked that the object of revising Vinson-Trammell is not to prevent the recapture of excess profits, but "to end a system to recapture excess profits which has not been effective, which has not been efficient, and which has really hit small businesses and not the large.

H.R. 5433 is a workable and effective solution.

(6) What is the impact of setting the filing floor at $1 million rather than $5 million?

This question was considered when the legislation was being drafted.

(A) With a $1 million floor, DOD's workload would quadruple:

WORKLOAD (CONTRACTUAL ACTIONS PER YEAR)

$1 million floor: 8,000.
$5 million floor: 2,000, 800 prime contracts; 600 1st tier subcontracts; 600 contract changes, aggregating more than, $5 million.

(B) With a $1 million floor, DOD's annual costs of implementation may exceed $1.6 million, not including compliance costs to contractors and subcontractors:

IMPLEMENTATION COST (ANNUAL)

$1 million floor: $1.6 million (at least).
$5 million floor: $1 million (includes DOD and contractor compliance costs).

(C) With a $1 million floor, DOD's staff needs will increase substantially:

STAFF

$1 million floor: 46 (includes 25 auditors).
$5 million floor: 13 (includes following positions: 4 rulemaking; 6 auditing; 3 administrative support).

(D) With a $1 million floor covering 8,000 contracts each year it is estimated that 10 percent of such contracts will involve small businesses. SBA staff indicate that very, very few small businesses are awarded DOD contracts in excess of $5 million. While some small businesses may be subject to the profit limitation under H.R. 5433, it appears that this will occur less than 1 percent of the time on 2,000 contracts.

SMALL BUSINESS IMPACT

$1 million floor: 10 percent of 8,000 contracts.
$5 million floor:: less than 1 percent of 2,000 contracts.

(7) Will H.R. 5433, if enacted, be implemented by another agency resembling the Renegotiation Board?

H.R. 5433 would require reviews of DOD's largest noncompetitive contracts. DOD will implement the act and the reviews can be conducted without hiring a large additional staff. The excess profit determination involves no subjective analysis such as that engaged in by the renegotiation board.

(8) Would H.R. 5433 subject foreign military sales (FMS) to Vinson-Trammell?

Section 2(b)(1) of H.R. 5433 sets the criteria for contracts subject to the 15 percent profit ceiling. one requirement is that the acquisitions be made with appropriated funds. (See section 2 (b)(1)(1).) The history of the Vinson-Trammell Act reveals its application only to contracts paid for by appropriated funds. Prior to 1972, FMS were sometimes paid for by appropriated funds and later. the foreign government would reimburse DOD. Since that time, however, DOD has instituted what is called "direct-site funding." Under this procedure, a revolving fund is created for a foreign government: That government deposits funds in the account and contracts are paid for through the fund. Therefore, FMS do not involve appropriated funds and are not subject to H.R. 5433.

For exceptions to direct-site funding which may occur, as well as for other situations calling for exemptions to Vinson-Trammell, H.R. 5433 at section (2)(h)(2) grants the Secretary of Defense or a designee waiver authority.

(9) Should H.R. 5433 apply to large noncompetitive contracts of other agencies as well?

Since the date when my bill was introduced, I understand that the OMB conducted a survey of the agencies to determine whether or not their contracts should be covered under H.R. 5433. The last response to the survey was filed on February 14. The results of that survey indicate unanimous agreement by the agencies against Vinson-Trammell coverage of their contracts. While I do not have further details about this survey, I am sure that OMB will gladly provide them to the committee.

Mr. Chairman, that concludes my testimony. I respectfully urge that your subcommittee consider H.R. 5433 as an alternative to the 1934 Vinson-Trammell Act and appreciate the honor of being able to present my views before this distinguished body.

Thank you.

[Additional inserts submitted by Congressman Patterson follow:]

OFFICE OF THE UNDER SECRETARY OF DEFENSE,
Washington, D.C., September 25, 1979.

Hon. JERRY M. PATTERSON,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. PATTERSON: This is in reply to your letter of September 12, 1979, which requested comments on a legislative proposal which would make certain revisions to the Vinson-Trammell Act of 1934.

Under your draft bill, profit limitations would apply only to large, noncompetitive contracts. Excessive profits would be determined using objective criteria with provision for offset of losses against profits. Amounts of profit earned as performance incentives or for value engineering achievements would be exempt from the profit limitations.

Your letter notes that the type of legislation that you propose has been opposed on the ground that existing procurement safeguards make unnecessary any excess profit limitations on noncompetitive defense contracts. Laws such as the Truth-in-Negotiations Act (10 U.S.C. 2306(f)) and the Cost Accounting Standards Act (50 U.S.C. App. 2168) help the Government substantially to secure fair and reasonable prices in noncompetitive procurements. These statutory tools, however, will not prevent the occurrence of unintended excessive profits.

You also requested our review of the definitions for "noncompetitive" contracts. Your draft bill utilizes the criteria now set forth in the Truth-in-Negotiations Act. These criteria appear to be appropriate for this purpose also. In our view, for the purposes of the Truth-in-Negotiations Act a follow-on contract would be considered competitive only if the price was based on adequate price competition.

We have provided the foregoing comments in order to assist you in the formulation of your proposals. Accordingly, these comments should not be understood as expressing our views on the merits of these proposals.

Sincerely,

DALE W. CHURCH,
Deputy Under Secretary
(Acquisition Policy).

OFFICE OF THE UNDER SECRETARY OF DEFENSE,
Washington, D.C., December 21, 1979.

Hon. JERRY M. PATTERSON,
U.S. House of Representatives,
Washington, D.C.

DEAR MR. PATTERSON: This is in reply to your letter of December 11, 1979, which requested comments as to whether the functions of the General Accounting Office (GAO) and the Defense Contract Audit Agency (DCAA) would preclude excessive profits under defense contracts and on the feasibility of a straight repeal of the Vinson-Trammell Act.

We believe the functions of the GAO and the DCAA would not prevent excessive profits from accruing to a contractor. Negotiated contract prices are based on a contractor's cost or pricing data and the judgmental factors applied in projecting from the data to the estimated contract cost. Cost or pricing data, being factual, can be audited by agencies such as GAO and DCAA. The judgmental factors, however, are not auditable and must be resolved through negotiation. Existing laws would not preclude a situation where a contractor would exploit a sole source marketing position to demand higher prices or profits than would be sought in a competitive environment, or where poor or hurried negotiations would result in a contractor realizing an excessive profit.

It would not be appropriate for us to comment on the feasibility of a straight repeal of the Vinson-Trammell Act prior to Office of Management and Budget approval of our report on the repeal bills. Accordingly, our comments should not be understood as expressing our views on the merits of either H.R. 5433 or H.R. 3254.

Sincerely,

ROBERT F. TRIMBLE,
Acting Deputy Under Secretary
(Acquisition Policy).

Mr. STRATTON. Now, you were present during much of Mr. McCloskey's testimony, and you heard, I gather, his position is different from yours. He feels that any kind of limitation as to profits is undesirable and that the moratorium should be permanent, that industry should police itself, that there should be no need for any governmental interference with respect to profits.

You, on the other hand, take the position, as I understand it, that the Vinson-Trammell provisions which are still included in the law with respect to profit limitations are out of date, which is putting it mildly for legislation that was enacted in 1934, and that they should be revised.

You are not suggesting there should not be some limitations on profits. Is that the case?

Mr. PATTERSON. That is exactly correct.

Mr. STRATTON. You say the bill before us, H.R. 7247, is an inadequate response to the problems created by a 1934 piece of legislation in the context of 1980; but you do understand, do you not, that the question of what changes should be made in the Vinson-Trammell sections, which is now the only legislation we have relating to excess profits, is a fairly complicated one.

It would take some time for this subcommittee to try to determine exactly what approach should be made. Your proposal, on the surface, strikes me as imminently fair. You also have pointed out something that Mr. McCloskey did not address. Maybe he was unfamiliar with the fact that, as you point out, there are many contracts the Defense Department has to award in which there is not a competitive situation. Therefore, the sky can readily be the limit.

Now, without some legislation in the background, this is what you would have. But Mr. Price's bill would suggest that while this committee, which usually moves with dispatch, sometimes on complicated matters takes time to reach agreement, it would require some time to come up with alternate legislation; and that while the committee deliberates, we should give industry a free ride for a year or so before we clamp back down.

Conceivably, Mr. Price might favor your particular approach.

The point I made, and you were not here when I made my opening remarks—and it is unfortunate because there is a lot of wisdom in that statement, and you may want to have a copy for your files——

Mr. PATTERSON. Thank you.

Mr. STRATTON. It seemed to me that, if we were to grant a waiver or grant a moratorium and then have this wise committee consider the matter and perhaps conclude, after due deliberation, that your legislation was what we actually needed and was what the doctor ordered, then we would have a lot of trouble in the House of Representatives, at least as it is constituted at the moment, and in the Senate perhaps even worse, in getting any kind of legislation back into law that would reimpose a limitation after 15 months of wild freedom.

I am wondering at this time if you would care to comment on the wisdom of that, which I think is the main thing we are trying to concentrate on now. In other words, is this waiver a good idea to give our committee a chance to ponder the matter with due judicial deliberation? Or is this waiver, once granted, going to let the genie out of the bottle, and we will never get it back in again?

Mr. PATTERSON. I can't fully answer that. I do not know what the schedule of the subcommittee is, nor the committee, but it seems to me the genie may not get out of the bottle, but it is postponing the day of reckoning. It would seem to me it could be done in less than a year.

If there were a suspension, it could be less than a year. I have discussed with Chairman Price the legislation which I introduced, and I advised him and the Department of Defense also advised him that they favor my bill. It is a fairly simple approach to what might be a complicated area.

It just simply says that we are going to look at only contracts awarded in excess of $5 million that are noncompetitive and that are limited basically to 15 percent maximum profits, which would equalize shipbuilding and aircraft. There are other nuances, but really it is not, in my opinion, all that complicated.

The Defense Department, I think, is willing to testify in favor of it. It just seems to me postponing it one more year to going to allow the forces to get together again to try to get 2 more years or a permanent repeal.

I know that Mr. Minish, on the one hand, would like to see Vinson-Trammell or some such restrictive or more restrictive legislation placed, and Mr. McCloskey would like to see total repeal.

I think the Patterson proposal is a compromise, and the only tinkering around that might be something the subcommittee could get into would be whether the $5 million figure is too high or too low. It could be $1 million or $3 million.

The other parts of it seem to be eminently fair. I would encourage the subcommittee to bite the bullet and take the bull by the horns.

Mr. STRATTON. Your recommendation would be, then, that we reject Mr. Price's bill and adopt yours or some version of it; is that right?

Mr. PATTERSON. I would never want to suggest rejecting the chairman's bill, if that is his intent. I think the issue before the subcommittee——

Mr. STRATTON. Excuse me. The only issue before us is whether a 15-month waiver is a good idea. I do not think you realize how much damage, at least in my view, passing the waiver bill would do to your approach.

I have been around here for a long time, as you know, and I have picked up not only Mr. Vinson's interest in defense, but also his feeling that, if we are going to award millions of dollars to contractors in defense, we should at least make sure nobody is ripping off the Government.

So, although he was perhaps more of a hawk when it came to defense industry than even I am, he was also insistent that there should be some kind of mechanism. In the last few years, as Mr. Minish is well aware, the pressures that have been building up here in the House and in the Senate have been tremendous for getting rid of all this kind of stuff.

Let these guys alone. They are good Americans. They are not going to rip off the Government. Mr. McCloskey told us it was costing industry $280 million—or billion, I cannot remember, but I think it

was millions—in order to keep all of the records and to hire all of the accountants to allow the Government to recover $7, $8 or $9 or $10 million.

Therefore, if we pass a bill that says that nothing shall apply between now and October 1, 1981, which is what the chairman wants us to do, or at least to consider, then October 1, comes along and we decide your bill is exactly the right thing: Then we are going to have to introduce this. We probably are going to have roughly the same basic constitution in the House and Senate.

I will ask Mr. Minish to comment on this when he testifies. But I would imagine that, considering all of the pressures on us to end the Renegotiation Board, doing something now about Vinson-Trammell, and tossing it out as Mr. McCloskey recommended, would make it almost impossible to get both Houses to adopt your legislation. It is unlikely Congress will say, "Having considered all things, we now think the Patterson bill is pretty darn good and we would like to adopt it."

That is the thing which bothers me about this moratorium.

Mr. PATTERSON. I understand, Mr. Chairman. Perhaps I did not respond to your question because I did not wish to be put into a position of opposing the chairman of the committee.

As to this issue, I think that it would be unwise to give any extension of time. I would oppose this here today. I would oppose it on the floor.

That does not mean that Mr. Price may not have had a very good reason for seeking adoption of the bill that he has presented to you. But I would hope the subcommittee does not report it out.

Mr. STRATTON. Let me make one other suggestion. Suppose we adopted one or two of your recommendations and said let them be in effect until October 1, 1981, to see how it goes, and if it will improve the productivity of our defense industry, which Mr. McCloskey said he felt was being damaged by the Vinson-Trammell legislation.

Mr. PATTERSON. I think the chairman's suggestion is a wise one.

Mr. STRATTON. Thank you.

Mr. PATTERSON. Yes.

Mr. STRATTON. I recognize Mr. Dan Daniel.

Mr. DAN DANIEL. Thank you, Mr. Patterson, for your contribution.

I plead ignorance about much of your bill. Unfortunately, we develop tunnel vision and do not have the time to do everything we want to do.

What I wish you would do during my 5 minutes is give us more information about your bill, if you will. What would be the practical effect of it?

Mr. PATTERSON. Yes.

Mr. DAN DANIEL. Go ahead, please.

Mr. PATTERSON. As you know, if Vinson-Trammell were reimposed, you would have different profit levels for aircraft and shipbuilding industries. Vinson-Trammell would apply to any contract in excess of $10,000. Those are the kinds of things, the inequity in the amount of profit, which are involved.

Now, whether or not 10 or 12 percent is adequate and whether or not it applies to contracts over $10,000, that is where I started in terms of looking at the direction in which to go.

Now, also, if every contract over $10,000 were subject to review, and the paperwork, et cetera, as we heard, it would become a mountainous job. As the Washington Post reported, reimposing the existing Vinson-Trammell act would mean shoveling paperwork through the door and not really examining it.

What the bill I have introduced does is that it takes a look at the major impact. These are the areas where profits need to be looked at, which are noncompetitive contracts. If you have a competitive contract, then, of course, the competition in the marketplace works. If you have a noncompetitive contract, it may or may not. In my judgment, it would not.

On the smaller contracts, you have to weigh the risks of whether or not the adding of a bureaucracy of staff returns anything to the taxpayer.

H.R. 5433 eliminates the 10- and 12-percent profit limitations on shipbuilding and aircraft contracts. The $10,000 floor was also eliminated. Instead, I recommend an across-the-board profit ceiling of 15 percent for large, noncompetitive DOD contracts. The contract floor was increased from $10,000 to $5 million.

As I say, that is not a magic number. That number could certainly be looked at with some scrutiny.

In effect, the new floor exempts small businesses. You exempt most subcontracts, except for the very large ones. You catch the large contracts and large subcontracts over $5 million that are noncompetitively let.

They are reviewed. The IRS rules could govern in this. The effect of this would be recovery of any excess profit—any excess over the 15 percent—which would be returned to the Federal Government.

I have an example which was submitted in the testimony of how the computation might work. For example, if you are a contractor of $6 million, and let us say there was a profit of $1,200,000 on that, then the 15 percent of the $6 million contract is $900,000. Therefore, that is the allowable profit on that contract. As to the excess, the $300,000 excess, it would either have to be returned, or if the contractor should show that certain portions of this were due to performance incentives or other agreed upon provision for improved production, then that could be retained as profit.

Mr. DAN DANIEL. What was used to upgrade machinery or to improve procedures to increase production? What method was used?

Mr. PATTERSON. Only if it would come under the terms of performance incentive or value engineering. I am not sure in that proposal if it would come under the latter.

If it did, they would be allowed to claim this as in excess of the 15 percent. If not, then they would not under the bill as I have introduced it. I am sure it would be the will of the subcommittee to be worked out as to any areas you feel might be necessary.

In essence, the review that would have to be done by DOD would be only 7 percent of the total contracts. It would be a minor number, but it would cover 57 percent of the procurement dollars, and only for noncompetitive contracts.

Mr. DAN DANIEL. I thank the gentleman.

There is one thing that bothers me. It is not necessarily what you said, but it was indicated that somehow "bigness" is "badness." That is not what you really intend to say.

Mr. PATTERSON. Not at all. What I am saying is that "bigness" has two advantages. One is to the taxpayer. If there is an excess profit on a large contract, then there is more recovery. There is more scrutiny of the contract. There is more protection of the public treasury.

The other side of "bigness" is as to the firms and industry. A large firm has the capability of complying with the reporting process. Every large firm would have in-house counsel, or it would have accounting personnel and contract negotiators, et cetera. It would be easier for them to comply.

Large contract coverage under Vinson-Trammell is less burdensome for the Federal Government and cost effective. Additionally, an onerous burden would be removed from the backs of small contractors who cannot afford the burden.

Mr. DAN DANIEL. We cannot escape the conclusion that all of that would go to extra costs, whether it is big or little.

Mr. PATTERSON. It would add some. I am not sure it would add too much cost to the contractor because the contractor has to produce a contract price, and then whatever documentation to produce that price is already there. The Department of Defense, I believe, indicated they might need 8 to 13 additional personnel to review those kinds of contracts.

The additional work would largely be on the part of the Defense Department in reviewing the paperwork if there is the contention that there is excess profit.

Mr. DAN DANIEL. Which would, of course, increase the Federal payroll.

Mr. PATTERSON. I would assume, unless they can absorb it within the existing staff, that you are talking about 8 to 13 personnel. I should not testify on their behalf, but I did hear that figure.

Mr. DAN DANIEL. I thank the gentleman.

Mr. PATTERSON. Thank you.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

Mr. STRATTON. I recognize Mr. Beard.

Mr. BEARD. Thank you for your very fine statement and in-depth research you have apparently done in this particular area.

For the first time, I have seen an article in the Washington Post today, an editorial, that I think was somewhat presumptuous. It made some assumptions.

Did the gentleman read the article?

Mr. PATTERSON. Yes.

Mr. BEARD. It made some pretty harsh innuendos concerning the tremendous lobbying efforts. Four years ago, in response to a strenuous grassroots lobbying drive by defense contractors and subcontractors in every State, Congress acted to kill the Renegotiation Board, a tiny Federal agency that was recouping about $40 million annually in excess profits from Pentagon contractors.

What is the gentleman's attitude on that? Was the Renegotiation Board a viable, successful agency that was overrun by these people?

Mr. PATTERSON. I may have to protect my back side because Mr. Minish is present, and perhaps he can better respond to this, but I felt

for the return that there was more cost to the taxpayer going out in that agency than was really being returned. Something needed to be done.

Mr. BEARD. Was this thought developed because you were overwhelmed by the defense contractor lobbyists, or did you show an exception—and maybe you voted this way out of principle because it did not seem to be enough of a record to substantiate its existence? Were you overwhelmed by the hardcore forces of lobbyists?

Mr. PATTERSON. I was not overwhelmed by the hardcore forces. I believe I was not.

Mr. BEARD. You actually placed principle before yielding to the big boys?

I want to commend you on that.

Mr. PATTERSON. Yes.

Mr. BEARD. If that reporter is in the room, I would hope he would take note that that is not how everything is done on the Hill, although it gets good black and white ink when they write it. When did you introduce your bill, Mr. Patterson?

Mr. PATTERSON. It was September 27, 1979.

Mr. BEARD. Where was that bill originally referred? I guess it was referred to the Armed Services Committee?

Mr. PATTERSON. Yes.

Mr. BEARD. Does the gentleman know which subcommittee it was referred to?

Mr. PATTERSON. I do not know.

Mr. BEARD. It was the Procurement Subcommittee, I am told.

Mr. PATTERSON. Yes.

Mr. BEARD. If you do not know which subcommittee it was referred to, that would tell me there had been no hearings.

Mr. PATTERSON. That is correct.

Mr. BEARD. No hearings on the House side, but you have appeared before the Senate?

Mr. PATTERSON. I have appeared before Senator Morgan's subcommittee on the Senate side, and I had a meeting with Mr. Price, and I met with the Department of Defense. I have discussed it widely.

No hearings have been held on it.

Mr. BEARD. We have known this thing was coming to a head for quite a while, I would presume. I have been quite naive or very unaware of the whole scenario until these hearings.

Now, Mr. Chairman, I think one of the strong recommendations we could make, and it could probably be referred to the Procurement Subcommittee because that is where the bill was originally referred, would be to insist or to request that the chairman call for immediate hearings on these different pieces of legislation.

This is not a very good way to do it. We are developing words for a record to go into a Senate conference with the House. This seems to be important enough for us to have some good, healthy hearings.

Would the gentleman like to comment on that? I am sure you would like some hearings also.

Mr. PATTERSON. I certainly would. I know the legislative year is getting late, the implementation of the act is coming into play. I think that is the problem the subcommittee finds itself in, which is not a

comfortable one. No one I know of wants to institute Vinson-Trammell in its present form.

Some would want to do away with it entirely and go for repeal. I think there are dangers in both of those approaches. The suspension is what you are faced with.

I would hope that this particular matter could be concluded within this legislative year so a suspension would not be necessary.

Mr. BEARD. Does the chairman have a familiarity with the record on this, with regard to the committee's attitude? Have you had any discussions with the Procurement Subcommittee chairman or the chairman of the full committee as to why we have not had hearings on these particular pieces of legislation?

Mr. STRATTON. If the gentleman will yield, the gentleman is aware of the fact that the chairman of the Procurement Subcommittee also is the chairman of the full committee. The chairman of the full committee introduced this legislation. The chairman referred it to this subcommittee.

He further suggested, as I said in my opening statement, that this subcommittee hold detailed hearings on it in the 97th Congress. Now, God willing, some of us may be back in the 97th Congress. Nobody knows who is going to make up that Congress.

The chairman felt this was not a subject that could be gone into in a hurry. In fact, Senator Morgan, before whose committee the gentleman from California testified, himself concluded this is too complicated and complex for him to get into in the 96th Congress. Therefore, he put in the companion to Mr. Price's bill in the Senate authorization bill.

So I do not think we can expect to get into all of these details. As I indicated earlier, my own feeling is that a moratorium might turn out to be something, once we have given it, that we could not get back. Therefore, maybe there should be some other approach to ease the problems industry is having.

I think they have lived this thing so long that probably another few months is not going to upset them, if we can come up with the proper solution.

Mr. BEARD. I think the chairman has given another beautiful, objective example or reason as to why this Congress desperately needs to be controlled by the Republican Party so that the power will not continue to be abused in this fashion.

I thank the chairman. I hope the American people hear this message.

Mr. STRATTON. I would like to inform the gentleman, since he seems to be licking his chops a little bit with that statement, that the Republican Party in my district has declined to run anybody against me.

Mr. DAN DANIEL. Will the gentleman yield?

Mr. BEARD. I am not sure. Should I?

Go ahead.

Mr. DAN DANIEL. The gentleman referred to the article in the Washington Post this morning.

Mr. BEARD. Yes.

Mr. DAN DANIEL. I resent any suggestion of implication that this subcommittee would enter into any sort of sweetheart agreement or contract with the Senate or any subcommittee thereof. It is obvious,

I think, to me and those who know Sam Stratton, he does not enter into sweetheart contracts with anybody.

Mr. STRATTON. Thank you.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

Mr. STRATTON. Any further questions?

Mr. BEARD. No.

Mr. STRATTON. Go ahead, Mr. Robert Daniel.

Mr. ROBERT DANIEL. I have no questions.

I would concur in what my cousin down the table said. I do not consider myself part of any plan or plot which would be predestined in having the hearings. I do not think they are "quickie" hearings with this impressive witness list.

Thank you, Mr. Chairman.

Mr. STRATTON. Thank you.

Mr. ROBERT DANIEL. Nothing further.

Mr. STRATTON. Have you any other final comments?

Mr. PATTERSON. Thank you.

I think the suggestion you made that if this is the vehicle, it is something the subcommittee should consider to tack on a few restrictions that would apply during any period of suspension or moratorium that were not possible to adopt in a comprehensive program. It would seem to me that you could adopt a 1-year program and commence your more thorough hearings next year. You would have something to go into conference with with the Senate.

Mr. STRATTON. You mention in your testimony that the Department of Defense supported your bill.

Mr. PATTERSON. Yes.

Mr. STRATTON. Now, Mrs. Gilleece tells me we have been unable to get them to confirm that in writing. We will try to get that out of them, or worm it out of them.

As the members of this committee well know, it is difficult to worm things out of the Department of Defense. We would be happy to have any further information on this.

Mr. PATTERSON. Hopefully somebody behind me will be able to comment on that. If I can find anything in my file, I would be happy to submit it to the chairman of the subcommittee.

Mr. STRATTON. Thank you very much. Your testimony has been very helpful.

Our next witness is Hon. Joseph G. Minish from New Jersey, and I understand, Mr. Minish, that Mr. Gonzalez of Texas is also here. We will be very happy to have you both.

STATEMENT OF HON. JOSEPH G. MINISH, A REPRESENTATIVE FROM NEW JERSEY

Mr. MINISH. I have asked Mr. Gonzalez to come along. He has a vital interest in this.

Mr. Chairman and members of the subcommittee, I can see the handwriting on the wall. Two weeks ago the Senate Armed Services Committee added an amendment to this year's authorization bill which suspends the Vinson-Trammell Act until October of 1981.

Now there is a hearing in the House Armed Services Committee dealing with the same proposal. The net result of these two events is

that when the conference on the defense authorization bill starts, the House conferees will be under enormous pressure to accept the Senate's Vinson-Trammell suspension.

All the lobbying weight of a $70 billion industry will settle upon the heads of the House conferees. Telegrams by the hundreds will pour in and old friends who are also defense contractors will just happen to call. I do not have to describe it any further. We have all seen it before.

Mr. Chairman, let's be realistic about this hearing. It sets the stage for a major, far-reaching change in the way we do our defense business. If Vinson-Trammell is suspended, it will be the first time in almost 50 years when there is no actual or possible check on the profits of defense contractors. If things go as they seem to be going, this could all be done without ever having a markup in either of the House committees which share jurisdiction over Vinson-Trammell. We would be throwing away protections which our country needs and deserves without even going through the proper legislative process.

And while we are being realistic, Mr. Chairman, let's admit that a temporary suspension of Vinson-Trammell, which should have been enforced back in late 1976, is probably the first step on the road to a permanent repeal. The machinery for promulgating any profit limitations will grind to a halt. The need for quick and comprehensive action will slide into the background. And the defense industry, which does not want any checks or limits on its profits, will have inertia on its side. We all know how much easier it is to stop legislation than to start it.

Profiteering on defense contracts is a problem. It was a problem when George Washington complained about it during the Revolutionary War, and it is a problem today. Our Government has been trying to control excessive profits on defense contracts since the Spanish-American War. Yet today, when we are spending more money than ever on defense, Congress seems willing to surrender to the special interest lobbies and abolish all profit-limiting legislation.

As we all know, President Carter has proposed substantial increases in our military budget. I do not have to tell the members of the House Armed Services Committee that we already spend an enormous amount of money on defense procurement. According to the Department of Defense, we spent over $65 billion on procurement in 1978. This was an increase of almost $10 billion over the 1977 figure.

With this increase and the certainty that our military spending will continue to rise, the American people have a right to expect you and I will protect their tax dollars and that their money is spent wisely and not thrown away.

I think most people would agree that there are two ways to insure reasonable prices and profits for the defense industry. One would be to leave the question of price to the marketplace. I believe that in a healthy and truly competitive market, we could rely on price competition to insure that we get the best bargains for our dollars.

However, according to the Department of Defense, only a fraction of defense contracts, usually less than 15 percent, are awarded on the basis of price competition. In 1978, 63.8 percent, almost two-thirds of all defense procurement, went to sole sources.

The percentage of sole source awards has risen and will apparently continue to rise every day. In 1976, 57 percent of our procurement dol-

lars went to sole sources. In 1977, that amount rose to 62.4 percent and, as I said, in 1978 it rose again to 63.8 percent.

In addition to the large sole source awards, most of the remaining Government contracts are given out in situations where there are only a few competitors and where, because of technical, engineering, or other factors, there may be little or no competitive pressure to keep prices and profits at a reasonable level.

Therefore, in many segments of the defense industry, the Government faces a seller's market where contractors set prices. Because Government demand reflects our national security needs rather than market pressures, the Government often finds itself in a situation where it has to have hardware and must pay whatever the contractor asks. In such cases, the only way the Government can protect itself is to review contracts after they are completed and to recover any excessive profits at that time.

The defense industry and its supporters will attack any form of profit limitation by contending that our defense procurement system had built-in safeguards which can prevent excessive profits. In many cases, that is not true. No Government procurement safeguard or refinement places a limit on how much money the Government will have to pay a sole source defense contractor if the contractor names his price and refuses to proceed with the work until his demands are met. In a seller's market, the DOD has little leverage to negotiate lower prices and no existing DOD procurement safeguard gives it the authority to do so.

It is worth noting, but seldom mentioned, that practically every independent study of our procurement system has recommended post-contract curbs on excessive profits. Among those studies are:

One, the report by the staff of the Joint Committee on Internal Revenue Taxation, September 30, 1975;

Two, the GAO Report, "The Operations and Activities of the Renegotiation Board," May 9, 1973;

Three, the GAO Report, "Causes of Excessive Profits on Defense and Space Contracts," December 31, 1975;

Four, Report of the Commission on Government Procurement, December 1972;

And, five, Report by the Committee on Government Operations, "The Efficiency and Effectiveness of Renegotiation Board Operations," December 16, 1971.

On the other hand, there have been no independent studies which have recommended abolishing all procurement watchdog agencies. In fact, the only studies I have ever seen which recommend abolishing watchdog agencies have been done under the auspices of the defense industry. To say the least, I question the objectivity of studies supported by those with such an enormous vested interest.

I feel that I should also mention that while the spokesmen for the defense industry cite procurement safeguards as obviating the need for watchdog agencies, these same industry representatives are doing their best to eliminate those safeguards.

For example, the defense industry right now is in the midst of a concerted effort to kill one of the procurement safeguards they cite, the Cost Accounting Standards Board. If you do not believe me, ask some

of the defense lobbyists about their views on the Cost Accounting Board when they testify here.

In summation, if we had true price competition in the defense industry, I would say that we do not need a watchdog agency. However, with two-thirds of our defense dollars going to sole sources, there has to be some other way of insuring that the taxpayers we represent get true value for the enormous amount of money we spend for defense. The only way to do this is to have an independent agency looking over the shoulder of the DOD and the defense industry.

Not surprisingly, I am not thrilled with the Vinson-Trammell Act in its present incarnation. It is unfair in that it applies only to a small portion of defense contractors and that it places an unreasonable burden upon small businessmen.

But I do believe that Vinson-Trammell can be amended to make it a fair and useful check on profiteering by defense contractors. Most independent experts, including the Department of Defense and the GAO, agree with me that it should be amended, not killed. Yet this committee seems ready to take a long step, perhaps an irrevocable step, in the direction of killing Vinson-Trammell.

In my opinion, we already made grievous error when we killed the Renegotiation Act and swept $150 billion in unexamined contracts under the rug.

Now, Mr. Chairman, getting rid of this law even temporarily would be another serious mistake. It would be contrary to the public interest. It would be just plain wrong, and it should not happen under any conditions.

I thank you for the opportunity, Mr. Chairman. I will answer any questions, after my colleague, Mr. Gonzalez makes some remarks.

Mr. STRATTON. Thank you.

Do you wish to be heard?

STATEMENT OF HON. HENRY B. GONZALEZ, A REPRESENTATIVE FROM TEXAS

Mr. GONZALEZ. If it does not in any way impede the smoooth flow of your procedures, if possible I would.

I wish to state I certainly affirm what Chairman Minish has stated to your subcommittee. I am the next ranking member of that subcommittee. My identification here historically goes back to 1967. I was given credit for singlehandedly then saving the Renegotiation Board, and precisely in this month of June, 13 years ago.

Now, this was with the same arguments, except at that time, it was under the jurisdiction of the Ways and Means Committee. It was about to expire under heavy pressure and after many amendments. The Congress had approved this and it had reduced the effectiveness, and it had hamstrung the Renegotiation Board.

It is interesting to note, in view of what has been said here about the article in the newspaper this morning, that the leading critic and the one at that point claiming the credit for eliminating the Renegotiation Board is a Member of the House lately has been one of the most fervent lobbyists for this pertinent segment of the defense industry.

If anything, the Post article this morning was extremely mild. If anything, I would say that it shows the lack of concentration in this

very important area of concern to the taxpayer on the part of the media, or the press generally, which has more or less overlooked this.

Maybe they have not had time because they have concentrated on so many other activities in connection with the Government.

But summing up, let me say I was also given credit during the reform resolutions for moving the jurisdiction of the Renegotiation Board from the Ways and Means Committee to the substantive legislative committee, the Banking and Finance Committee. I had the honor of serving next to Chairman Minish on the committee since its creation.

There is no question that this is a continuing problem. No matter how we try to soften the language and call it "excess profits," it is plain, old-fashioned war profiteering. If anything, even peripheral studies and observations made, such as the GAO, clearly reaffirm that the war profiteering is rampant. It is more rampant than even during the height of the procurement during Vietnam. The figure now has exceeded in our present budget this figure.

I wish to expressly stress and underline what Chairman Minish just said. With the action proposed here, you will for the first time in 50 years—and in fact, really for the first time in history of our Government since Washington's problems with war profiteers—you will leave the public interest stripped naked of any kind of protection.

I was surprised to learn of these hearings, and I learned about them through happenstance. I wish to end up by complimenting the chairman, the very distinguished chairman, who I recall has had some experience in exposing some procurement scandals a few years ago in some specific instances that I remember.

I remember reading about them in the newspaper. So I know that the distinguished chairman's interest has been long and abiding, but I am afraid that the skids are greased and there is very little, if anything, that will be done to change the course of events around us.

I will say that sitting here and listening to the present outspoken leader, who credits himself for the elimination of the Renegotiation Board, that it sounds very much to me that it is a very able spokesman for this affected industry and their plea. This reminds me of Abraham Lincoln's old story about the man who threw himself on the mercy of the court. He was accused of having killed his parents. It was on the basis that he was now an orphan.

These Members of the Congress and this interest, ever since Secretary Forrestal, who historically was the one that we really ought to give credit for being the father of Renegotiation—he was the first Secretary of Defense. He fought hard and almost did not succeed, but since his time, there is no question that the main purposes for which Secretary Forrestal sought the erection of the Renegotiation Board served their purposes well.

And if there was any inefficiency, as charged by the Congressman from California, it was because of the crippling amendments that the Congress imposed on the Renegotiation Board. Now that we have the complete elimination of this in the Vinson-Trammell act, which has been nonexistent because it has only been partially enforced—it is the law of the land, but it has not been enforced—maybe it does need amendments, but I do not think that excuses us or the Members of this

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Congress or any prior Congress for turning over to the war profiteers the hard-earned tax funds of this Nation.

It especially seems to me to be contradictory at a time when the very same committee is exacting a demand on a certain segment of our youth to qualify for registration and to offer their input, while at the same time dismissing from any kind of oversight the most flagrant sector of abuse in procurement, in our procurement levels today in defense.

I thank the chairman for having these hearings. This is the only surprise I have had. I did not expect to have hearings after I knew the Senate had amended their bill the way it did.

I want to thank you for your tremendous contribution in the defense of the safeguard of the taxpayers' interest and in defense itself and for the opportunity to be heard.

Mr. STRATTON. Thank you very much, Mr. Gonzalez, for your generous remarks, and I thank Mr. Minish for his testimony.

Let me just say in response to what Mr. Minish has indicated here, as to the handwriting on the wall, I would refer you not only to the article that appeared in the Washington Post this morning, but also to my opening remarks. I am not sure whether Mr. Minish has had a chance to look at them.

I can assure you and you will recall that I supported you for the continuation of the Renegotiation Board. I have been very unsympathetic with Mr. McCloskey's efforts over a number of years to try to wipe out Vinson-Trammell. These hearings certainly are going to be addressed to the particular question of what should be done about this legislation.

We intend to examine the impact of a moratorium. The chairman of the committee, Mr. Price, introduced legislation that would provide a moratorium or a waiver. I think it was simply because he realized a similar proposal was in the Senate authorization bill.

Now, as conferees on the part of the House, we would be faced at the time with that particular issue, rather than just walking in there naked and unprepared, as Mr. Gonzalez said, and we would like to have a real understanding of what the impact of this legislation would be.

The chairman, as far as I am concerned, simply introduced the bill so that we could examine it and, as the gentleman from Texas has said, this subcommittee looks into these matters in depth if they are matters we are asked to accept. It seems to me we already have here several points of view. Mr. McCloskey has said, in effect, that we do not need any limitations on profits whatsoever; that defense contractors are having a tough time making a buck; they are good American people; they certainly will not go over 15 percent. If we take off all of the limitations, we will have a much better productivity. The country will be much better off.

I am not sure whether you subscribe to his position, but I think essentially those were his words.

Now, Mr. Patterson has come in and said the Vinson-Trammell Act is a little bit out of date. It was proposed back in 1934. This is when I was just entering college. It probably is a little bit old.

Now, the percentages and the figures and the cost limitations and so on are out of date, but he has proposed not throwing the baby out with the bath, but improving the action, and improving and modernizing the limitations in the various ways that he has supported.

I gather, Mr. Minish, you would actually agree with that approach, would you not, because you stated you were not thrilled with it, and it is unfair that it applies only to a small portion of the defense contractors and places an unreasonable burden on the small businessman.

You think that it can be amended. So you would essentially support the position of Mr. Patterson, would you not?

Mr. MINISH. Not necessarily.

First, I am pleased to have the reassurance of the chairman. There is not any doubt in my mind, with Mr. Stratton sitting in the chair, that everybody will get a fair shake, that no one will have to go to any conference and not have the facts.

With regard to the article in the paper this morning, not only have I not read it, and I have not talked to anybody at that paper for sometime, so I do not know what is in it. I am not concerned about it. But I do not agree with what Mr. Patterson said.

There is a difference of opinion between the amount of money covered in Mr. Patterson's bill and in ours. He would examine only individual contracts over $5 million.

In our bill, the one I sponsored with others on the committee, we have a $3 million aggregate floor. That is $2 million more than the Renegotiation Board had under its statute.

Mr. STRATTON. We have not been able to get into the details. All I am saying is you are obviously not supporting Mr. McCloskey.

Mr. MINISH. You are exactly right.

Mr. STRATTON. He said why don't we amend it to be more applicable today; that is what Mr. Patterson said.

Mr. MINISH. I agree with that.

I have trouble following Mr. McCloskey. I think sometimes he is like the fellow that tries to stand up in a bushel of jellyfish.

Let me quote from a hearing that we held in March of 1979, and Mr. McCloskey is speaking: "We ought to have a uniform law to repeal Vinson-Trammell and set one figure and say that no company doing business with the government ought to make more than, say, a 15-percent profit or a 12-percent profit."

I do not have any objection to that. That is what he said. He continued: "We are going to have to invest in Vinson-Trammell." I am working on a bill now to try to bring in a reasonable profit level on defense contracting, but that bill ought to extend across the whole industry. It should not just affect ships and aircraft, as Vinson-Trammell does.

So we are going to have to modify it. Then he puts the bill in to kill it. I have trouble following what Mr. McCloskey says anytime, anywhere, any place.

Mr. STRATTON. Who killed the bill?

Mr. MINISH. He put a bill in to eliminate the Vinson-Trammell Act after he made the statement. I have trouble following him. Mr. Chairman, excess profits should be returned to the taxpayers, the U.S. Treasury; it is wrong for any company to keep them.

Mr. STRATTON. He said he was in favor of not only putting a limit on ships and aircraft, but also on other things.

Mr. MINISH. Yes.

Mr. STRATTON. At the same time he put the bill in to kill it.

Mr. MINISH. Yes. This is a hearing that the subcommittee held in March; it was March 22, 1979.

Mr. STRATTON. Let me ask one other question. This was mentioned in my opening remarks.

The thing that bothers me is the same thing that bothers you. As you say, if we adopt a temporary waiver of the Vinson-Trammell Act, this might be the first step to a permanent repeal.

Mr. MINISH. There is no question about it.

Mr. STRATTON. Chairman Price has said that he is proposing a moratorium or a waiver for a period of 15 months, simply because this is a complicated matter. He would like to have the subcommittee spend some time in the 97th Congress reviewing the details in coming up with your recommendations on Mr. Patterson's or somebody else's.

Now, while this is going on, he would give everybody kind of a free ride in order to take the heat off until he could come up with new legislation. We have not gotten into this yet. It is a complicated matter.

My understanding is that the Price bill is extremely more limited in scope, in terms of the people who get home free under it, than is the section adopted by the Senate. The thing that bothers me is that, if we institute a moratorium by legislation which is what we would be doing, on October 1, 1981, when this comes around—and maybe by that time this subcommittee will have accepted the point of view of yourself and Mr. Patterson and a few others, that is we do need something—then is it not going to be extremely difficult with the temper of the House and Senate, as we have seen over the last few years, to get a bill passed repealing the moratorium?

Mr. MINISH. Positively. There is no question about it. This is not as complicated as people would have us believe. You do not need 16 or 18 months as a deferment. They were deferred since 1976. IRS is working on this now.

I think if there is interest in getting a reasonable bill patterned after the Minish-Patterson bill, you can get it out and get it on the floor in the next 2 months.

Mr. STRATTON. You said most independent experts, including DOD and GAO, agree Vinson-Trammell should be amended and not killed. I understand the DOD's position on this is a little ambiguous. Do you have anything in writing?

Mr. MINISH. It is my understanding they testified to that point before Senator Morgan's committee.

Mr. STRATTON. We will have them testify today. So we will be able to get their views.

Mr. MINISH. Thank you.

Mr. STRATTON. Thank you very much.

Mr. Dan Daniel?

Mr. DAN DANIEL. Thank you, Mr. Chairman.

I thank the gentlemen for their testimony. I think it is good to have the different views presented to use because we are going into this in some depth.

I am particularly pleased, Mr. Minish, that you raised the issue of the sole source procurement. When Mr. Church appears before the Subcommittee, I hope he will be prepared to respond to what appears to me a rather outrageous situation.

We appreciated your comment.

Mr. MINISH. Thank you.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

Mr. STRATTON. Have you concluded?

Mr. DAN DANIEL. Yes.

Mr. STRATTON. Mr. Robert Daniel.

Mr. ROBERT DANIEL. I have no questions. I just want to make the observation on the testimony of the gentleman from New Jersey, that he says the Senate Armed Services Committee amendment and the House Armed Services Committee proposal are the same.

There is a substantial difference in that the House provision would have the cutoff date being when final payment was made before October 1, 1981; whereas the Senate amendment refers to contracts completed before October 1, 1981. The final payment and the completion are not the same time.

Mr. MINISH. There is a slight difference, but the objectives are the the same.

Mr. ROBERT DANIEL. It could make quite a difference in the application.

Thank you.

Mr. MINISH. Thank you.

Mr. STRATTON. Mr. Beard.

Mr. BEARD. I know you have not had the opportunity to read the Washington Post. My boy delivers it every morning at 4:45. I have to start my day with this.

I just want to say what this reporter quoted you as saying. And I know you would not have said it about this committee.

Mr. MINISH. Tell me what he said. I may disagree.

Mr. BEARD. He said that you were quite concerned.

"It's all wired," said Rep. Joseph G. Minish (D–N.J.), the most outspoken House supporter of continued profit controls. "They hold this quickie hearing, and then the House guys use that to go along with the Senate bill in conference."

You did not say that, did you?

Mr. MINISH. I did not read the article as yet but that does not mean I disagree with what he said.

I want you to understand very clearly I did not talk to any reporter of the Washington Post, nor have I read the article.

Mr. ROBERT DANIEL. If the gentleman from New Jersey is quoted correctly in the Washington Post, with those words, perhaps it is wired.

Mr. MINISH. I am not so sure.

Mr. BEARD. I do not want to pursue that.

Very quickly, and my major concern is the small businessman, the subcontractor, but do you feel there is a need for sensitivity toward the smaller subcontractors who do not have the wherewithal to fulfill all of the requirements, et cetera?

Mr. MINISH. I am pleased that you asked that. Positively.

Now, the renegotiation bill that we had in, we had to increase the floor from $1 million to $5 million. This would have eliminated, I am

informed about 40 percent of all small business, people doing business with the Defense Department, that would have been eliminated.

I agree with you completely. I had mentioned earlier—and counsel tells me that we have a $3 million floor in our bill—in Vinson-Trammell it would eliminate quite a bit. There is no question that small business cannot compete with big business.

Big business has large law firms that represent them. There is nothing wrong with that. That is part of the American system. If a small businessman comes in here and has to go out and get legal representation, he might be paying more for a lawyer than the contract is worth.

Mr. BEARD. Paying more than the contract may be worth to him?

Mr. MINISH. Yes.

Mr. BEARD. The Patterson approach seems somewhat reasonable, though I am not familiar with it. But Mr. Gonzalez stated the taxpayers are totally naked—well, they are not totally naked. As a matter of fact, they are pretty well clothed when you consider we have the Truth in Negotiations Act. We have the Defense Contract Audit Agency. We have the Defense Contract Administration Services Branch. There is a lot of clothing out there still.

Mr. GONZALEZ. That is just a bikini.

Mr. BEARD. It is always just the beginning in Government. It is never the end.

Mr. GONZALEZ. This just a bikini.

Thank you, and I just wanted to say this. Even then, as the chairman pointed out, it is being fought to be eliminated now by the same people who have consistently fought any kind of oversight, whether it is profit or the renegotiation process itself.

Mr. MINISH. If I could address that question. In the last 12 months of the existence of the Renegotiation Board, all of the agencies that you were talking about were in effect. Notwithstanding that fact, they still found $82 million in excessive profits.

The agencies you referred to were around then. They found $82 million in excessive profits in the last year the Board was in effect.

Mr. BEARD. You said the Board found $82 million?

Mr. MINISH. Yes.

Mr. BEARD. Did they collect the $82 million?

Mr. MINISH. The Board was done away with.

Mr. BEARD. If they found it, they would have had to collect it. Why was the Board there if they did not collect it?

Mr. MINISH. Some of these items have not been resolved.

Mr. BEARD. So the due process has not been completed?

Mr. MINISH. No. The history shows at least $45 to $50 million will be found in favor of the taxpayers.

Mr. BEARD. I thank the gentleman.

Mr. STRATTON. In that connection, when Mr. McCloskey was here, he testified that industry was having to spend $280 million annually to prepare the various forms required by the Renegotiation Board. They only collected between $7 and $10 million for that huge expenditure.

He indicated the Government could have picked up that money in taxes anyway without the Renegotiation Board. Now, you say that in

the last year they picked up $82 million. You spent a lot of time looking into the Renegotiation Board.

What is the record of its performance? Is this $280 million a cost against industry; is that figure supported by any facts you know of?

Mr. MINISH. I think when my good friend goes back to the aerospace country the air sends him sky high. It said here that the estimate is $255 million, and somebody else said $40 million. Another was $400 million, and there is an estimate of $140 million.

The GAO said no one has any figures on it. Industry does not have the figures.

I recall reading in a magazine where there were three figures, ranging from $75 million to about $280 million, in the same article. So whom do you believe?

I will rest my case with GAO. I will read what they say. It is a letter to me:

> We concluded that some costs are necessarily incurred by the contractors to comply with the Renegotiation Act requirements. We were unable, however, to determine the magnitude of such costs or to what extent they are incremented to the other financial data costs.

The primary problem in determining and verifying costs was that the contractors' accounting systems were not designed to identify and segregate such data. This was from the General Accounting Office.

Mr. BEARD. You rest your case with GAO?

Mr. MINISH. Yes, sir.

Mr. BEARD. I presume you rest your case with the GAO statement that there should be a waiver, and that they do support the House language versus the Senate language?

Mr. MINISH. No, I do not know that they said that. When I rested my case, it was on this particular item and nothing else.

Mr. BEARD. You only agree with GAO in this particular case. They are a credible source now?

Mr. MINISH. I am stating facts. They sent the letter.

Mr. BEARD. The statement GAO made was that they supported the House language in the waiver They supported the House language or the Senate language in the waiver of the Vinson-Trammell Act.

Mr. MINISH. Maybe they were commenting between the two and not necessarily what they really believed in. I am convinced they will do the right thing.

Mr. BEARD. Thank you.

Mr. MINISH. They do not have much of a choice. I am sure if you get them here under testimony, they probably will say it is wrong, to completely eliminate controls on profits.

I want to thank you, Mr. Chairman. I know you are in the Carl Vinson Room, and he is looking down on you. I am sure you will do the right thing. Thank you very much.

Mr. STRATTON. Thank you, Mr. Minish. Thank you, Mr. Gonzalez.

Mr. GONZALEZ. Thank you.

Mr. STRATTON. Thank you for your enlightening testimony.

We have a long witness list, and we should proceed with the GAO which you have been mentioning because we think they will address themselves to the various kinds of waivers before us. That is the essential issue we want to address this morning.

Our witness from the GAO is Mr. Walton Sheley, the Acting Director of Procurement and Systems Acquisition Division.

We would be happy to have your testimony. However, we would like to take a break around 1 p.m. So, hopefully, we can touch on those matters and can have an opportunity for questioning, and then take a break for lunch around 1 p.m.

STATEMENT OF WALTON H. SHELEY, ACTING DIRECTOR, PROCUREMENT AND SYSTEMS ACQUISITION DIVISION, GENERAL ACCOUNTING OFFICE

Mr. SHELEY. Thank you, Mr. Chairman.

Mr. Minish has put us in a rather difficult spot, but our testimony was prepared on the basis that you were faced with a situation of the Senate amendment and the proposed amendment by Chairman Price. The question is: Which is the best deal? That is what we have basically addressed our testimony to.

Mr. STRATTON. I thought Mr. Minish was saying, just as the situation is today with respect to Presidential candidates, some people do not like any of the above and they have to choose between which they are still going to pick. I assume that is what you are saying.

Mr. SHELEY. That is right.

We testified before Senator Morgan's committee, and this very question came up about the moratorium or deferring action on it. Our position was we did not want to see it deferred, but recognizing the practicality of getting new legislation, something had to be done to give a little bit of relief. If you are going to pass any kind of moratorium, we would be in favor of the House language for several reasons. That is the thrust of the remarks I would like to make this morning.

Mr. STRATTON. You may proceed.

Mr. SHELEY. Mr. Chairman and members of the committee, at your request, we are here today to present our views on H.R. 7247, the proposed legislation to waive the application of the Vinson-Trammell Act to October 1, 1981.

As you know, the Vinson-Trammell Act, enacted in 1934, places fixed limits on profits of contracts and subcontracts over $10,000, for the manufacture or construction of all or part of a complete military aircraft or naval vessel. With the abolition of the Renegotiation Board, this act, dormant for many years, became operative.

Although restricted to the ship and aircraft categories, the scope and implications of the act are far-reaching. Because of its low-dollar-minimum reporting requirement, it would cover practically all tiers of subcontractors and material suppliers that contribute to a completed aircraft or vessel. This requirement will affect many small businesses never previously subject to a profit limiting statute. In addition, it will affect those contractors selling commercial products that become part of an aircraft or ship.

There is almost unanimous agreement, both inside and outside of Government, that the Vinson-Trammell Act in its present form is not workable. The defense picture has changed so radically since its passage that it is no longer relevant.

The dollar threshold is far too low—many thousands of small contracts with relatively miniscule profits would be covered, creating a paper avalanche that would serve no useful purpose. The classification of items covered—only ships and aircraft—is so restrictive that it will exclude many major procurements, while at the same time being so imprecise as to be impossible to enforce.

While the General Accounting Office agrees that the Vinson-Trammell Act is outdated and should be replaced, we believe that the question of whether or not this act should be replaced with a new statute is a matter of policy which the Congress should determine after considering all of the advantages and disadvantages.

As we all recognize, the subject of profit limitations is both exceedingly complex and controversial. In order that a careful and thoughtful process of consideration take place, it is necessary that the implementation of the Vinson-Trammell Act be concurrently suspended.

This suspension would not only provide for further study, but at the same time remove the burdens and inequities on contractors during this interim period. Therefore, we support the proposed legislation to postpone implementation of the act until October 1981.

As requested in your letter of June 12, 1980, we compared the language of H.R. 7247 with a similar provision included in the 1981 Defense Authorization bill recently approved by the Senate Armed Services Committee. Although we have been unable to obtain a copy of the Senate bill, we were able to gain limited information from portions of the Senate report accompanying the bill.

While both bills have the same objective, that is, to suspend the application of the Vinson-Trammell Act on particular contracts and subcontracts, they differ in their timing and approach toward accomplishing the objective. The Senate amendment proposes to exempt contracts and subcontracts if performance was completed prior to October 1, 1981.

According to the report of the Senate Armed Services Committee, the committee expects that the Department of Defense will issue regulations defining when performance on a contract can be said to have been completed.

The House bill, H.R. 7247, exempts only those contracts and subcontracts with respect to which final payment has been made prior to that date.

Mr. STRATTON. What you just said is not in. Could you repeat that?

Mr. SHELEY. In order to assure application of the exemption to subcontracts that have been totally performed and paid for during this period, the moratorium period, this can occur years before final payment is made on a prime contract. And we recommend the language be amended to specifically include subcontracts with respect to which final payment has been made by the prime contractor or the subcontractor.

Liability for excess profits under the Vinson-Trammell act attaches to contracts and subcontracts completed during a taxable year. Existing administrative regulations define completion of contract as "date of delivery" of the item or portion thereof covered by the contract or subcontract.

If the Department of Defense follows this definition, then all contracts and subcontracts to which liability for excess profits would have attached would be exempt under the Senate bill. In the event that the Department adopts some other definition of completed performance, then the coverage under the bill could be different.

The language of H.R. 7247 is more specific as to coverage. It would exempt only those contracts where final payment has been made. Contracts that have been completed prior to October 1, 1981, on which final payment has not been made prior to that date, and contracts still active would not be covered under this waiver. If the Vinson-Trammell act is subsequently retained in October 1981, these contracts would be subject to its profit limitations.

We note that the House bill excludes the October 1, 1976, date. This is the date when the act became effective again. If the intent of this exclusion is to exempt, as a precautionary measure, those contracts entered into prior to that date which for some reason may be affected by the act, then we would have no objection.

Another provision in the Senate amendment prohibits the responsible agencies from requiring any reports under current law, or issuing regulations to implement that law before October 1, 1981. It is our opinion that this provision is not necessary to produce the desired effect. However, we would have no objection to its inclusion in H.R. 7247.

In summation of H.R. 7247, in our opinion, the language therein presents no definitional problems, and for simplicity of administration, the approach taken appears to be a reasonable one. Its effect will be to, one, waive the applicability of the Vinson-Trammell act on contracts and subcontracts entered into before October 1, 1981, on which final payment has been made; and two, retain the applicability of the act on all other contracts and subcontracts for which final payment has not been made.

On the other hand, the stated effect of the Senate amendment is to, one, exempt from the Vinson-Trammell act contracts and subcontracts entered into before or after October 1, 1976, if they are completed before October 1, 1981; and, two, continue the application of such act to contracts and subcontracts entered into after October 1, 1976, but which are not completed until after October 1, 1981, except that there would be no reporting requirement until after October 1, 1981.

In our opinion, a major factor in the Senate amendment is the subsequent definition of completed performance.

In conclusion, the General Accounting Office has supported profit limiting legislation in the past and, as we have recently testified, believe that some type of statute is needed in certain cases and during a period of national emergency.

It is our opinion, however, that the present Vinson-Trammell act is unworkable. We endorse legislation to suspend the statute to allow the Congress the opportunity to reconsider the entire area of profit limitations on Government contracts.

We believe that in determining which contracts would be exempt in the interim period, from a practical standpoint, the final payment approach in H.R. 7247 would appear to present the least administrative difficulties.

This concludes my prepared statement, and I will be glad to answer any questions that you may have.

Mr. STRATTON. Thank you, Mr. Sheley.

I have not really had an opportunity to explore this subject in considerable depth in order to see whether I really understand what the two different approaches involve.

I wonder if you could give us some specific examples.

Mr. SHELEY. Yes.

Mr. STRATTON. Now, the Senate legislation appears to say virtually the same thing. I guess one difference is that it has the starting date of 1976; is that right?

Mr. SHELEY. Yes.

Mr. STRATTON. This refers to any contract which was completed during the period beginning October 1, 1976, and ending September 30, 1981. The wording of the Senate language is any contract or subcontract, the performance of which was completed.

You said the issue there hung on how the Defense Department would define "completion." Now, what is involved is the completion of performance.

Does your statement on page 4 still apply, that the completion of performance would be the date of delivery of the item?

Mr. SHELEY. That is one interpretation. One of the problems with the Senate bill is that the term "completion of performance" is not nearly as precisely or definable as "final payment."

The other effect of it would be that many contracts remain open for considerable periods of time after delivery of the last unit under that contract. Some I have seen run as long as 10 years before final payment may be made on them. The House bill, in effect, would narrow the universe of the number of contracts that would be exempted under this. It would require final payment action rather than completion of performance.

Mr. STRATTON. I would suppose that, in an ordinary cycle, a certain number of contracts would get completed every day, and statisticians could take a look and say, "We usually complete three or four contracts every day." So if 90 contracts are completed during a month, that is the way we do it.

I am trying to figure this out. You would assume that no matter how you define "completion," a certain number would be completed within a 15-month period. A certain other number would be paid for within that period.

Are there fewer examples of contracts being paid for within a 15-month period than being completed in a 15-month period?

Mr. SHELEY. I do not know if there would be fewer, but what you would be doing would be continuing the applicability of the Vinson-Trammell Act to more current contracts rather than to older contracts, that is, if you go with the final payment date.

Mr. STRATTON. There would be more of an opportunity for a manufacturer to claim that his contract was subject to the waiver because he had completed the performance.

Mr. SHELEY. That is correct. It is very difficult to define. Sometimes the delivery of the unit, for example—well, does "delivery" mean delivery and acceptance, or just the tender of delivery on the part of the

contractor. You get into all kinds of definitional problems when you say "delivery" or "completion."

It is not as precise a term as "final payment." "Final payment" means the last payment. That is very precise.

Mr. STRATTON. Is that the date the check is signed and presented?

Mr. SHELEY. Yes.

Mr. STRATTON. Is that right?

Mr. SHELEY. Yes, Mr. Chairman.

Mr. STRATTON. There would be less ambiguity in the current language.

Mr. SHELEY. Yes, sir.

Mr. STRATTON. OK. Now, you are not an expert in legislative procedure, I would gather, although GAO has been around a long time and has been looking into congressional activities. What about the concern I have expressed here from the start? Once we grant a waiver, we are then going to have to take, when the waiver period expires, further positive legislative action to get either the Vinson-Trammell Act back on track, as it existed when this legislation went into effect, or have some alternative.

In other words, it is not just automatic. It is not just going to be automatic that, once October 1 comes along, we have this legislation which is back on the books.

Is it not true, as Mr. Minish has said, that if you waive this you have really killed it?

Mr. SHELEY. As you pointed out, I am not an expert in the legislative process. I think that will depend on the will of the 97th Congress.

Mr. STRATTON. They would not have that opportunity if we did not give it to them by passing this legislation. They would not, would they?

Mr. SHELEY. They would not.

Mr. STRATTON. What about the possibility of some temporary amendment that could be an improvement over the unrealistic figures in the current Vinson-Trammell Act, but would not necessarily embrace all of the improvements one might make? I said in my statement perhaps the percentage of profit could be raised a little to make it more realistic. The cost figure could be raised a bit.

Would that be a feasible thing you could put in on a temporary basis until October 1, 1981? Then you could amend it further if you wanted to do something more.

Mr. SHELEY. I am sure you could do that, but it would require the concurrence of the Senate as well. They seem to have gone on record already with regard to the waiver. I am not involved in the political process of the Congress. I could not answer that question specifically.

It is a distinct possibility that you could amend it. There is no question about that. Whether it could be sold through the Congress as a whole is something I cannot answer.

Mr. STRATTON. Let me put it one other way.

Mr. SHELEY. Yes.

Mr. STRATTON. You would not be in favor of simply wiping out the Vinson-Trammell Act now, and then having it remain out. You feel we need some kind of legislation.

Mr. SHELEY. Very definitely. We have testified to that on many occasions. We feel there are many circumstances where profit limitation is

appropriate. The further you get toward a noncompetitive contract, the more profit limitation requirements exist.

The closer you get to a fully advertised contract, the less concern there is for profit limitation. On an advertised contract, you never know what the profits would be.

Mr. STRATTON. I do not believe that Mr. Price indicated he wanted to wipe it out. I think he felt this would be a way of postponing the decision as to what changes should be made. As of the expiration date of this legislation, if the old act had not been improved in the meantime, it would be back on the books.

So if the best legislative opinion is that once a waiver got started, it would continue until some positive legislative action was taken to reinstate the legislation, and if it was the best legislation or legislative opinion, which was that the temper of the Congress would be extremely opposed to reimposing such a limitation, then you, I take it, would not be in favor of a waiver.

Mr. SHELEY. I would not be. The way I read the legislation, both House and Senate, it only postpones it until October 1, 1981. It does not kill it. Until October 1, 1981, it provides a moratorium period in there for the Congress to consider what type of legislation should be there.

Mr. STRATTON. Thank you.

Mr. SHELEY. Yes.

Mr. STRATTON. Why do you believe that the provision in the Senate amendment prohibiting responsible agencies from requiring reports is unnecessary?

Mr. SHELEY. I just do not believe that DOD would take any overt action. There would be a lot of wasted effort based on the possibility of revised or replacement legislation. I just do not think they would want to invest that type of manpower in developing new regulations prior to October 1, 1981. It would still be uncertain as to whether or not you are going to have Vinson-Trammell or some replacement legislation for it.

I certainly do not object to it being in there, but I am not sure it is necessarily essential.

Mr. STRATTON. In your view would it be reasonable for the criteria for exemption to be the fiscal year 1981 or the prior year appropriations?

Mr. SHELEY. I would have difficulty with that. That is mainly because of the type of contracting practices that exist. For example, naval vessels are put under contract or one could come under contract in 1981 and not be completed for 5 or 6 years. That contract would be exempt.

Now, airplane contracts are less of a problem. They are usually purchased on annual buys. That is not as much of a problem, but with the ships it would present a problem.

There is also the possibility or probability that many contracts that are awarded are amended subsequently by modification, and there would be continued exemption of the contract for an indefinite period of time.

Mr. STRATTON. I have one other question.

Mr. SHELEY. Yes.

Mr. STRATTON. Have you followed the activities of the Renegotiation Board at all?

Mr. SHELEY. Yes, sir, we have in past years. We have looked at it recently. In what respect were you asking?

Mr. STRATTON. I wonder if you have any information which could either support or contradict the statement of Mr. McCloskey that industry was under the Renegotiation Act charged with about $280 million worth of excess paperwork to carry out the obligations of the act, and that only $7 million to $10 million was recovered per year.

Mr. SHELEY. I do not know if we have anything, Mr. Chairman, with regard to the cost of the paperwork, per se, other than the report we gave to Mr. Minish, which said we were unable to ascertain with any degree of certainty as to how much that would be.

We are running into the same thing. We get allegations on cost accounting standards. We have been doing work for Senator Proxmire on that. You cannot come to a precise figure.

On the performance of the Renegotiation Board, we have data. I do not have it with me today, but we will supply it for the record if it would be of benefit, as to what their claims were and what they ultimately collected on the claims.

Mr. STRATTON. I think Mr. Minish indicated $82 million during the last year, which is quite a different figure from $10 million.

Mr. SHELEY. I am not sure which is right. I think it is somewhere in between.

Mr. STRATTON. Thank you.

[The following information was received for the record:]

The Renegotiation Board in its final report, dated October 16, 1978, on fiscal year 1978 operations (the last complete fiscal year of operations recorded), reported, among other data, the following:

"Excessive profits determinations are made by the Board before adjustments for non-Federal taxes measured by income and before deductions of credits for Federal income taxes. The aggregate amount of [37] fiscal 1978 determinations on such basis was $34,286,000. * * * after adjustments for non-Federal taxes * * * but before the deductions of credits for Federal income taxes, [the figure totaled] $31,495,240. * * * For the 10 fiscal 1978 determinations, for which Federal tax credit data are available, the after-tax total is $4,359,468. [Board expenses during fiscal 1978 totaled $6,158,720.]

"* * * From its inception through September 30, 1978, the Board made 4,756 determinations of excessive profits, totaling $1,354,628,588. After * * * tax adjustments and credits, the total was $576,137,775. * * * [Since the Board's inception, excessive profit determinations totaling $377,578,838 were appealed to the courts.]"

An indication of the extent of Board determinations in its final months is obtained from testimony during 1979 congressional hearings to extend the Renegotiation Act. The Acting Chairman of the Renegotiation Board testified on March 22, 1979, before the Subcommittee on General Oversight and Renegotiation of the House Committee on Banking, Finance and Urban Affairs, regarding the recent record of the Board on excessive profit determinations. He stated that in the 12 months from March 1, 1978 through February 28, 1979, the Board had found excessive profits amounting to $82,256,000. Of that amount, $34,285,000 were determined in the last 7 months of fiscal year 1978.

Since the Renegotiation Board records are in storage, we were not able to independently verify the accuracy of these figures.

Mr. STRATTON. Have you any questions?

Ms. GILLEECE. No questions.

Mr. STRATTON. I think at this point we will recess for lunch and return at 2.

At that time, some of the other members of the subcommittee may want to question you, although I am afraid most of them were not here for your testimony.

Then we will resume with the other witnesses.

Thank you.

Mr. SHELEY. Thank you.

Mr. STRATTON. If you could come back at 2, we would appreciate it.

Mr. SHELEY. Yes, sir.

Mr. STRATTON. The subcommittee stands in recess until 2.

[Whereupon, at 1 p.m., the subcommittee adjourned for lunch, to reconvene at 2 p.m. the same day.]

Mr. STRATTON. The subcommittee will come to order.

Our next witness is a very distinguished gentleman, Admiral Rickover, USN.

We would be very happy to hear your testimony with respect to the legislation pending before this subcommittee, which was introduced by Chairman Price, H.R. 7247, which would impose a 15-month waiver on the provisions of the Vinson-Trammell Act regarding the cost figures for defense contracts and profit figures. This subcommittee would examine in some detail and make recommendations on the possibility of amending the Vinson-Trammell sections.

STATEMENT OF ADM. H. G. RICKOVER, USN, NAVAL SEA SYSTEMS COMMAND

Admiral RICKOVER. Thank you, sir.

As you know, Mr. Price has been a great friend of mine for many, many years. In fact, it is due to his efforts that I am still around here. I regret very much that I must take a stand contrary to what he proposes.

But since Mr. Price is also a personal friend of mine, he will realize that I am testifying as to what I believe in, just as he testifies to what he believes in. I hope you will forgive me, Mr. Price.

The CHAIRMAN. Yes.

Admiral RICKOVER. I strongly recommend that this committee not endorse H.R. 7247, nor agree to similar provisions in conference with the Senate. If Congress exempts contractors, even temporarily, from the Vinson-Trammell Act, in the absence of an effective substitute, it would become very difficult, if not impossible, to reinstate or strengthen the act or other profit-limiting legislation.

Historically, Congress has endorsed the principle that making excessive profits on defense contracts is contrary to the public interest. This problem was even recognized by George Washington.

The issue now before Congress is whether it intends to retreat from this fundamental principle.

As one who has been involved in defense procurement since before World War II, I can think of few things that would be more injurious to the defense procurement process and as costly to the American taxpayer than for the Congress of the United States to condone, by word or deed, excessive profits on defense contracts.

In 1934, Congress, in passing the Vinson-Trammell Act, set profit limits on defense contracts for ships, aircraft and their components.

In 1942, this act was suspended in favor of the Renegotiation Act, and an excess profit tax.

The Renegotiation Act gave the Government authority to recoup excessive profits on a much wider range of contracts. Under Renegotiation, factors other than just profit percentage were considered in determining whether a contractor's profits were excessive.

In its most recent form, the Renegotiation Act remained in effect from 1951 to 1976, as temporary legislation, which Congress reviewed every 2 or 3 years.

In 1976, the House approved the bill to strengthen the act, but it died in the Senate Finance Committee where it was never brought to a vote. The Renegotiation Act itself expired when those in the Senate who opposed the House bill were successful in keeping a bill for routine extension of the act from coming to the floor for a vote.

Since then, opponents of renegotiation have been able to block efforts to revive the act, just as I am convinced that they would be able to block efforts to revive or strengthen the Vinson-Trammell Act if Congress ever suspended it.

Defense lobbyists were able to persuade the Appropriations Committees to cut off the Renegotiation Board's funds as of March 31, 1979. At the time the Board went out of business, there was a $150 billion backlog of defense contracts that had not yet been screened for excessive profits.

When the act expired on September 30, 1976, the Vinson-Trammell Act once again became applicable to the defense procurements. Although the Internal Revenue Service is responsible to implement the Vinson-Trammell Act, that agency has been procrastinating apparently in the hope that Congress will repeal the act. It did not publish the proposed implementing regulations for public comment until October 1979, which was more than 3 years after the law went into effect.

However, the Internal Revenue Service has repeatedly postponed the date for contractors to file under the Vinson-Trammell Act. Apparently defense contractors exert considerable influence at the Internal Revenue Service, as they do in the Defense Department.

The objective of the defense industry is clear. It is to eliminate or neutralize as many procurement safeguards as they can. It is worth remembering that when Congress was considering legislation to establish the Cost Accounting Standards Board, the defense industry lobbyists said the Board was unnecssary because the Renegotiation Act precluded excessive profits.

If there are no excessive profits being made by the Defense Industry, I can see no reason why they have so many lobbyists here this afternoon.

Later the same defense industry lobbyists pointed to the existence of the Cost Accounting Standards Board as one of the safeguards that permitted repeal of the Renegotiation Act. Now that the Renegotiation Board has been abolished, these lobbyists are trying to kill both the Vinson-Trammell Act and the Cost Accounting Standards Board.

The need for Congress to provide for recovery of excessive profits on defense contracts arises because there is little or no competition for most major defense hardware. The Defense Department is often

in a take-it-or-leave-it situation. With many of its major programs, large, one-time costs often preclude developing alternate sources for the follow-on type orders.

Although there may be some negotiation in arriving at the final figures, the Government often has no choice but to meet the contractor's price.

The following are recent examples from my own experience. One large corporation has a virtual monopoly on nickel products in the United States. Often the only competition for nickel alloys is between that firm and its own licensees.

Recently the Navy proposed to contract with this company for some developmental materials for possible application in future ships. The Navy contracting officer has determined that under the Truth in Negotiations Act, the company is required to submit cost or pricing data in support of the proposed price, or to submit data to demonstrate that this procurement qualifies for an exemption as commercial items sold in substantial quantities to the general public.

The company, which is headed by a former Assistant Secretary of the Navy, refuses to give the Government its cost breakdowns as a matter of policy, and readily admits it has not provided cost data to the Government since enactment of the Truth in Negotiations Act, almost 20 years ago. So for 20 years this company avoided the law. In an effort to avoid disclosing its cost and profit figures, the company now proposes to perform only one part of the work scope and to provide data which the firm contends will substantiate an exemption for that part of the work.

Without prejudging the company's submittal, this is an example of an essential supplier who refuses to disclose the profits he makes on defense contracts. Other material suppliers, computer manufacturers, petroleum producers, and other industries upon which the Government depends for defense needs, also refuse to provide cost data.

In these cases, Government contracting officers, in order to get the materials they need, tend to look for loopholes in the law and ways to rationalize how they can award the contract without getting the cost data.

This highlights the need for the Government to be able to screen for and recoup excessive profits.

Another situation arising only last week, a shipyard upon which the Navy has depended for ship design work demanded a 38-percent increase in the profit rate previously accepted for this type of work on a small cost reimbursement type design contract. Extensive negotiation failed to get the profit reduced to the historical rate.

The company, in effect, has confronted the Government with a take-it-or-leave-it proposition.

Another case involves shipbuilding contracts that the Navy is now negotiating for nuclear submarines authorized by Congress in the fiscal 1980 shipbuilding program. The Navy is currently trying to include provisions in the shipbuilding contracts which would require the contractor to identify potential contract changes promptly so that they can be resolved as they occur.

These provisions are designed to preclude submission of large, omnibus claims years after the fact, the sort of claims that have plagued

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the Navy during the past decade and for which we have a letter from this committee asking us to do something about.

Although some shipbuilder officials profess to share the Navy's desire to keep contracts current and on a pay-as-you-go basis, they at the same time insist on loopholes which would preserve their ability to assert claims years after the fact. That is a wonderful system because they wait until all of the people who are involved in the thing are gone. Then they submit the claim, and no one is around to fight it. That is why they do not like putting in their claims a short time later.

Now, by refusing to agree to provisions which insure that contracts can be kept current, some shipbuilders apparently believe that they can avoid this committee's mandate that the Navy shipbuilding contracts are to be administered on a pay-as-you-go basis. We are only trying to carry out what this committee wants.

Now, in another procurement, a large component supplier insists that future contracts must provide for a 35-percent return on investment in order to meet corporate profit objectives, or they will no longer supply defense equipment. I suggest every member of this committee buy stock in that company if it is earning 35 percent. I know of few companies in the country that do that well.

In this case, before we have alternative suppliers—the threat of the supplier leaving the business is not a problem, but the incident highlights the levels of financial return that some defense contractors consider the Government owes them, and the weakness of the Government in the sole source situations.

It also highlights the need for an after-the-fact review of the actual defense profits. In defense procurement competition does not provide adequate assurance against excessive profits.

Congress enacted profit limiting legislation and other safeguards in response to well publicized cases of contractor excesses. In recent years, these safeguards have been watered down or eliminated. Were Congress to excuse contractors from Vinson-Trammell for the period in question, some $200 billion of defense contracts would escape review. Even assuming that we may only recoup 0.5 percent as excess profits, there is $1 billion right there. It probably would be more. This is in addition to the $150 billion backlog that escaped review when the Renegotiation Board was abolished.

The Vinson-Trammell Act has its shortcomings. It should apply to all types of defense contracts, not just aircraft and ships, and also permit consideration of factors other than simply profit as a percentage of cost in evaluating the reasonableness of profits.

Perhaps Congress would want to exempt some small businesses, but these shortcomings are no reason to exempt all contractors from the Vinson-Trammell Act. I do not contend that the majority of defense contractors are profiteers. Excessive profits are not necessarily the result of deception or deliberate overpricing.

Unexpected changes in volume of business, unanticipated technological advances in the industry, a sharp change in economic conditions or honest errors can all lead to excessive profits, despite compliance with all existing procurement regulations, including preaward review of contractor proposals by Government audit.

But the notion put forth by defense lobbyists that defense contractors can be relied upon to exercise self-restraint in their pricing of

Government contracts is not only unrealistic, but completely contrary to fact and logic. It is in the interest of the individual defense contractors, as well as the public, to assure that firms which realize excessive profits have to refund them.

The American taxpayer expects and deserves proper accountability in the expenditure of public funds. It is up to Congress to insure that the billions of tax dollars spent on national defense do not include excessive profits.

For this reason, I urge that the committee not endorse H.R. 7247, nor agree in conference to similar provisions proposed in the Senate version of the fiscal year 1981 Defense Authorization Act.

And, finally, there is the moral aspect. I remind you what is stated in the Gospel of Matthew: "Where your treasure is, there your heart be also." We know for what the heart of some defense contractors beat but the heart of our citizens and lawmakers beat for a nobler purpose.

That is the conclusion of my statement.

Mr. STRATTON. Your complete statement will be included in the record.

WRITTEN STATEMENT OF ADM. H. G. RICKOVER, USN

Mr. Chairman, you asked me for my views on H.R. 7247 which would excuse defense contractors from the profit limits of the Vinson-Trammell Act from September 30, 1976, thru October 1, 1981. The House Armed Services Committee in conference with the Senate will soon be faced with a decision on whether or not to adopt a similar provision which appears in the Senate Armed Services Committee version of the fiscal year 1981 Defense Authorization Act.

I strongly recommend that this committee not endorse H.R. 7247 nor agree to similar provisions in conference with the Senate. If Congress exempts contractors, even temporarily, from the Vinson-Trammell Act, in the absence of an effective substitute, it would become very difficult, if not impossible to reinstate or strengthen the act or other profit limiting legislation.

Historically, Congress has endorsed the principle that making excessive profits on defense contracts is contrary to the public interest. The issue now before Congress is whether it intends to retreat from this fundamental principle. As one who has been involved in defense procurement since before World War II. I can think of few things that would be more injurious to the defense procurement process and as costly to the American taxpayer, than for the Congress of the United States to condone, by word or deed, excessive profits on defense contracts.

The problem of eliminating excessive profits on defense contracts is as old as the country itself. George Washington said about Revolutionary War profiteers:

"The matter I allude to is the exorbitant price exacted by merchants and vendors of goods for every necessary they dispose of. I am sensible that the trouble and risk in importing give the adventurers a right to a generous price, and that such, from the motives of policy, should be paid; but yet I cannot conceive that they, in direct violation of every principle of generosity, of reason and justice, should be allowed, if it is possible to restrain 'em, to avail themselves of difficulties of the times, and to amass fortunes upon the public ruin."

During the Spanish-American War, Congress tried to legislate against excessive profits on steel, which contractors were selling to the War Department at an exorbitant price. Congress set a maximum price for such sales, but, the steelmakers countered by refusing to sell steel to the Government. Under the pressure of war, Congress eventually had to rescind this law.

During World War I, Congress sought to limit profits through cost-plus contracts, control of raw material prices, and an excess profit tax. None of these worked.

In 1934, Congress, in passing the Vinson-Trammell Act, set profit limits on defense contracts for ships, aircraft and their components. In 1942, this act

was suspended in favor of the Renegotiation Act and an excess profit tax. The Renegotiation Act gave the Government authority to recoup excessive profits on a much wider range of contracts. Under renegotiation, factors other than just profit percentage were considered in determining whether a contractor's profits were excessive.

In its most recent form, the Renegotiation Act remained in effect from 1951 to 1976 as temporary legislation which Congress reviewed every two or three years. In 1976, the House approved a bill to strengthen the Renegotiation Act but it died in the Senate Finance Committee where it was never brought to a vote. The Renegotiation Act itself expired when those in the Senate who opposed the House bill were successful in keeping even a bill for routine extension of the Renegotiation Act from coming to the floor for a vote.

Since then, opponents of Renegotiation have been able to block efforts to revive the Renegotiation Act—just as I am convinced they would be able to block efforts to revive or strengthen the Vinson-Trammell Act if Congress ever suspended it.

Defense lobbyists were able to persuade the Appropriation Committees to cut off the Renegotiation Board's funds as of March 31, 1979. At the time the board went out of business, there was a $150 billion backlog of defense contracts that had not yet been screened for excessive profits.

When the Renegotiation Act expired on September 30, 1976, the Vinson-Trammell Act once again became applicable to defense procurements. Although the Internal Revenue Service is responsible to implement the Vinson-Trammell Act, that agency has been procrastinating—apparently in the hope that Congress will repeal the Act. It did not publish the proposed implementing regulations for public comment until October 1979—more than three years after the law went into effect.

Moreover, the Internal Revenue Service has repeatedly postponed the date for contractors to file under the Vinson-Trammell Act. The latest extension specifies a filing date of October 15, 1980. Apparently defense contractors exert considerable influence at the Internal Revenue Service as they do in the Defense Department.

The objective of the defense industry is clear—to eliminate or neutralize as many procurement safeguards as they can. It is worth remembering that when Congress was considering legislation to establish the Cost Accounting Standards Board, the defense industry lobbyists said the board was unnecessary because the Renegotiation Act precluded excessive profits. Later, these same defense industry lobbyists pointed to the existence of the Cost Accounting Standards Board as one of the safeguards that permitted repeal of the Renegotiation Act. Now that the Renegotiation Board has been abolished, these lobbyists are trying to kill both the Vinson-Trammell Act and the Cost Accounting Standards Board.

The need for Congress to provide for recovery of excessive profits on defense contracts arises because there is little or no competition for most major defense hardware. The Defense Department is often in a take-it-or-leave-it situation with many of its major programs. Large one-time costs often preclude developing alternate sources for follow orders. Although there may be some negotiation in arriving at the final figures, the Government often has no choice but to meet the contractor's price.

The following are recent examples from my own experience:

One large corporation has a virtual monopoly on nickel products in the United States. Often the only competition for nickel alloys is between that firm and its own licensees. Recently the Navy proposed to contract with this company for some developmental material for possible application in future ships. The Navy Contracting Officer has determined that under the Truth-in-Negotiations Act the company is required to submit cost or pricing data in support of the proposed price, or to submit data to demonstrate that this procurement qualifies for an exemption as commercial items sold in substantial quantities to the general public. The company, which is headed by a former Assistant Secretary of the Navy, refuses to give the Government its cost breakdowns as a matter of policy, and readily admits it has not provided cost data to the Government since enactment of the Truth-in-Negotiations Act almost 20 years ago. In an effort to avoid disclosing its cost and profit figures, the company now proposes to perform only part of the workscope and provide data which the firm contends will substantiate an exemption for that part of the work.

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In another procurement, a large component supplier insists that future contracts must provide for a 35 percent return on investment in order to meet corporate profit objectives, or they will no longer supply defense equipment This is a far better return than ordinary citizens realize on their savings. In this case because we have alternative suppliers, the threat of this supplier leaving the business is not a problem. However, the incident highlights the levels of financial return some defense contractors consider the Government owes them and the weakness of the Government in sole-source situations. It also highlights the need for an after-the-fact review of actual defense profits.

In Defense procurement, competition does not provide adequate assurance against excessive profits. It is easily possible for defense contractors to realize excessive profits despite full compliance with defense procurement rules and regulations, Government audits, and other safeguards that are applied at the front end of the procurement process.

Congress enacted profit limiting legislation and other safeguards in response to well publicized cases of contractor excesses. In recent years, these safeguards have been watered down or eliminated. Were Congress to excuse contractors from Vinson-Trammell for the period in question, some $200 billion of defense contracts would escape review. This is in addition to the $150 billion backlog that escaped review when the Renegotiation Board was abolished.

The Vinson-Trammell Act has its shortcomings. It should apply to all types of defense contracts, not just aircraft and ships, and permit consideration of factors other than simply profit as a percentage of cost in evaluating the reasonableness of incurred profit. Perhaps Congress would want to exempt some small businesses. But these shortcomings are no reason to exempt all contractors from the Vinson-Trammell Act.

I do not contend that the majority of defense contractors are profiteers. Excessive profits are not necessarily the result of deception or deliberate overpricing. Unexpected changes in volume of business, unanticipated technological advances in the industry, a sharp change in economic conditions or honest errors, can all lead to excessive profits despite compliance with all exitsing procurement regulations, including preaward review of contractor proposals by Government audit. But, the notion put forth by defense lobbyists that defense contractors can be relied up to exercise self-restraint in their pricing of Government contracts is unrealistic.

It is in the interest of the individual defense contractors as well as the public to assure that firms which realize excessive profits have to refund them. The American taxpayer expects and deserves proper accountability in the expendi-

ture of public funds. It is up to Congress to insure that the billions of tax dollars spent on national defense do not include excessive profits.

For this reason, I urge that the committee not endorse HR 7247 nor agree in conference to similar provisions proposed in the Senate version of the fiscal year 1981 Defense Authorization Act.

And finally I would remind you what is stated in the gospel of Matthew: "Where your treasure is, there your heart be also". We know for what the hearts of some defense contractors beat—but the heart of our citizens and lawmakers beat for a nobler purpose.

Mr. STRATTON. Thank you for that customarily eloquent statement.

We have in the bill before us, which Mr. Price introduced, a proposal for a moratorium or a waiver on provisions of the Vinson-Trammell Act, as has already been stated. That is the only legislation currently on the books to restrain defense profits, excessive defense profits.

But the witnesses who have testified—and you have also said the same thing—have said the Vinson-Trammell Act is not exactly up to date. It went into effect back in 1934. Perhaps some changes could be made to it, and I think you mentioned a couple in your statement. But the problem Mr. Price was addressing, if I understand his purpose—and perhaps he would want to comment himself—was that it will take some time for this committee and for the Congress as a whole to determine what changes ought to be made in Vinson-Trammell to do the kind of a job we want.

The chairman's bill is proposing that perhaps, if we were to take the heat off the contractors for a time to give this committee an opportunity to review all of the details presumably in the 97th Congress, once we come up with a suggestion, that suggestion could then be added to the law. We would be in a better position.

I had raised the point in my own opening remarks that, if we were to accept a moratorium, or a waiver, for 15 months, we might find it extremely difficult to reinstate the original law. I take it that is what you feel yourself, which is, even a temporary exemption is something that could become a permanent one.

You feel that the pressures against any improving legislation would be so great that regardless of what this committee might want to do, it would be almost impossible to get it enacted into law. Is that substantially what your view is?

Admiral RICKOVER. Yes, sir.

It would be another example of hope against experience.

Once you do away with profit limitations, you will have increasing pressure against reviving them. This is what I am concerned about.

As I noted in my testimony, I agreed that the Vinson-Trammell Act should be corrected, but meanwhile, we should keep on getting the money back that rightfully belongs to the Government. As I see it, here Congress is under pressure by larger elements of the population. There are people out of work. Congress is being asked to appropriate money to take care of the unemployed. At the same time you are doing that, then you are getting an argument from the defense contractors that we should forgive taxes which are properly owed to the Government. I do not see the logic in that at all.

I will give an anecdote. One time in the Atomic Energy Commission, the chairman of the Commission decided to give our nuclear submarine

information away to the foreigners. I said to him, "If you put this thing out to a vote of the American people, how would they vote?" He drew back, and withdrew his idea. I think if you put the profit-limiting issue up to the American people in the proper way, I think you will get a very quick, definite answer.

Mr. STRATTON. Do you think it would be possible for us to come up with a relatively simple set of amendments to improve the act and modernize it?

On page 7 you suggested it should apply to all types of defense contracts, not just aircraft and ships, and perhaps consideration of factors other than simply profit as a percentage of cost in evaluating the reasonableness of the incurred profit, and that Congress might exempt small businesses.

Would it be possible to provide perhaps a temporary fix for the Vinson-Trammell Act rather than a waiver?

Admiral RICKOVER. Yes, sir, I think it can be done. I think this committee in its hearings could very quickly determine what should be done. I have made some notes. I believe there are some basic elements that should be included in any profit-limiting regulation.

The law should apply to all defense work, not just ships and aircraft.

The law should apply to competitive, as well as noncompetitive, contracts. There are very few truly competitive contracts awarded by the Defense Department.

The law should allow for determination of a reasonable profit based on the nature of the work.

The law should apply to all but the smallest defense contractors. I will give a figure, if you care for it. I think if they do less than $5 million of business, then I would exempt them. That would do away with a lot of paperwork, and it would also do away with a great deal of pressure on Members of Congress.

The pressure from a small defense contractor may be greater than from a large one because there may be more people involved. Also the smaller people generally do not make the large sums of money on their work.

The law should not be administered by the Department of Defense. That will kill it right off the bat. You cannot trust that outfit to protect the taxpayers.

The law should not provide for special waivers or exemptions.

I believe that the Minish bill which you have heard about incorporates my ideas. I am against making it possible for people who have lots of money to avoid taxation, where ordinary people cannot.

On the other hand, if Congress is going to recommend that all taxpayers are exempt from paying taxes for 5 years, then I am all for this. I would like to be included in that list. [Laughter.]

Mr. STRATTON. We had testimony earlier from Mr. McCloskey who is one of the very strong, consistent opponents of the Vinson-Trammell Act. It was his information that industry would be required to spend $280 million a year to provide the various reports and forms necessary to meet the requirements of the Renegotiation Board.

In return for all of that expenditure, they only recovered something like $7 or $10 million a year.

Admiral RICKOVER. I would recommend, Mr. Chairman, that you ask him to give you the facts behind that figure.

Mr. STRATTON. I have already asked him to supply those. But I wondered if you, with your experience with the Board, might indicate whether those figures jibe with what you know to be correct.

Admiral RICKOVER. Those are the sort of figures that anyone can come up with, knowing you cannot challenge the amount. Business is required, for other reasons, to keep these records; nevertheless this sort of a statement is made often. It is made about the Renegotiation Board. They have never been able to justify it.

This sounds good as long as you do not ask the man for substantiation.

Ask him for substantiation to show how many people have to be hired and how many could be let go.

Mr. STRATTON. Thank you.

Have you any questions, Mr. Mollohan?

Mr. MOLLOHAN. No.

Mr. STRATTON. Mr. Robert Daniel?

Mr. ROBERT DANIEL. Thank you, Mr. Chairman.

I am no longer on the Seapower Subcommittee, but I am glad to see you.

On page 6 of your statement, you refer to the fact that future contracts provide for 35-percent return on investment, whereas the various figures can be 10, 12 or 15 percent. Those that we have been dealing with today are percentages of the volume of a contract, and not necessarily easy for me to relate to the return-on-investment figure.

In this case, what would the percentage of revenues to the contractor come to? In other words, the components, supply, insist on 35-percent return. Say it is $1 million. What would that be, the percentage of that $1 million contract?

Admiral RICKOVER. It is a little difficult for me to hear you, but as I understand your question, the answer would be it would be about 15 percent.

Mr. ROBERT DANIEL. Fifteen percent?

Admiral RICKOVER. Yes.

Mr. ROBERT DANIEL. The 35-percent return on investment, if the 15-percent figure is what it would be on the volume of a contract, is that out of line with what you consider reasonable?

Admiral RICKOVER. I beg your pardon?

Mr. ROBERT DANIEL. You are citing an example of return on investment and, as you presented it to us, I interpreted it as being an unreasonable insistence on the part of the contractor when, in fact, the terms of the volume of the contract would make it a reasonable figure.

Admiral RICKOVER. I think it is too much.

Mr. ROBERT DANIEL. Fifteen percent?

Admiral RICKOVER. Yes, 15 percent is too much. You cannot get 15 percent on your investments.

Mr. ROBERT DANIEL. I think we are talking about a different sort of investment. The one that one makes with a security compared to a book value investment on a balance sheet of a corporation——

Admiral RICKOVER. I am sorry, sir. It is difficult to hear you.

Mr. ROBERT DANIEL. The point I would make is that the 35-percent return on investment in this instance, where there are large compo-

nents of a supplier insisting on this—and I believe that was presented to us, and in your opinion that was unreasonable, an unreasonable thing upon which to insist.

Mr. FOSTER. Maybe I could explain that, Mr. Daniel.

Mr. ROBERT DANIEL. I just want to make this point. The 35-percent return on investment on the corporation's books, in this case the admiral tells us it is 15 percent.

Mr. FOSTER. Yes, sir about 15 or 18 percent. It is one of the problems, which I believe you recognize, that the relationship between return on investment and profit as a percentage of cost changes with each individual corporation.

Mr. ROBERT DANIEL. I am a former practicing financial analyst. I appreciate that. That is why I am asking this.

Now, 35-percent return on investment, is that what it is?

Mr. FOSTER. Yes, sir, and in our judgment that was excessive. The company arrived at this figure by estimating the amount of capital that they have to finance and the working capital plus a very negligible amount that they have in net property, is still not written off on the books. They must make 35-percent return on investment, no matter what that turns out to be as a percentage of costs. The 35-percent figure is actually understated because they based it on incurred costs instead of actual cash layouts.

We felt it was excessive.

Mr. ROBERT DANIEL. I think it is useful for the subcommittee to note the 35-percent return on investment equates to the figure of 15 percent. Even the strongest proponents on contractors' profits or control of it say that is reasonable in the hearings today.

Mr. FOSTER. The admiral has recommended that factors other than percentage of cost be considered, in evaluating the reasonableness of profits as was required by the Renegotiation Act. Sometimes even a 5-percent profit as a percentage of cost may be a very excessive profit. Maybe 15 percent is reasonable in some situations.

Mr. STRATTON. Mr. Dan Daniel.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

It is the opinion of this member that no citizen of this country has made a more substantial contribution to our national security than Admiral Rickover. I think perhaps in about 99 percent of the cases his views and mine are in harmony.

In this instance through I have a little difficulty because, in the first place, I do not know what an excess profit is. I do not know what a windfall profit is. If it is what some bureaucrat says it is, then that is no more valid than what I would say it is—or maybe not as valid because I have had some experience in the field itself.

But, Admiral, you talked about defense function escaping review. I do not know of any defense function that escapes any review. It is the responsibility of Congress, as I understand it, to see that the taxpayers are not abused.

In the opinion of this member, there are times when there are better ways of reaching that objective than by legislation. We have some very good auditors on this committee, and I would prefer to take their judgment about whether the taxpayer is being gouged and whether there is a reasonable profit, rather than taking some bureaucrat who will carry

the regulations over that might come about as a result in any legislation we pass.

The objective is the same, to protect the taxpayer. I think there are better ways of doing it than to continue to put the laws on the books, such as this.

Admiral RICKOVER. What would you do, just eliminate all of the rules on profits?

Mr. DAN DANIEL. No, sir.

Admiral RICKOVER. We do not have true competition. Where you have true competition, there is no question.

Mr. DAN DANIEL. You did not hear me either, Admiral. What I was saying is, it is our responsibility to see that the taxpayers are not abused. We have our own people to oversee these activities. If we are not doing it, then we should be replaced.

I do not think we need to stack more laws on top of each other. Maybe we can do the function ourselves by carrying this with our oversight responsibility.

Admiral RICKOVER. You would need a very large staff. It takes many people in the Defense Department to perform this function.

Mr. DAN DANIEL. Let us wait just a minute. Maybe we have a better sense than some people in the Defense Department have or in some regulatory agency. Maybe we can do it with fewer people.

Admiral RICKOVER. Perhaps you can, but as I see it, you have limitations that you have on the number of employees. Also you are the legislative branch—and what I think you are suggesting would involve you in the executive functions.

Mr. DAN DANIEL. I do not agree with you. I think it is our responsibility to oversee these things. I do not think anything escapes some review by the Congress that goes to the Defense Department. I do not think they think anything escapes it either.

Admiral RICKOVER. When you enact the law, you are requiring the executive agencies to carry out your desires.

Mr. DAN DANIEL. That is what we intend to do. That is not what is done.

You know what happens in a regulatory agency as well as I do. That is why we are passing bills now, to cure the situation. We write a bill with a certain intent. When it gets to the regulatory agency, it does not resemble what was passed by the Congress. That is why we are talking about this.

Admiral RICKOVER. I certainly do not advocate that any regulatory agency or anyone in the executive branch not carry out the intent of the Congress. You know my philosophy, sir, I thoroughly believe in that.

Mr. DAN DANIEL. I am sure you do. You have always exercised that position in everything I have known you to do.

My point is if we continue to burden industry, whether it is Government contracts or private contracts, with regulations piled on top of regulations, and paperwork piled on top of paperwork, we will become noncompetitive in the world market. That is what is happening to us today.

Admiral RICKOVER. We are only talking about Government contracts. We who are responsible for entering into contracts with in-

dustry must depend on the laws enacted by Congress to see that the people are protected. We are carrying out your mandate.

Mr. DAN DANIEL. You are carrying out the oversight responsibility. I think in one instance one is preferable to the other.

Admiral RICKOVER. That is entirely the judgment of the Congress. You have the authority to take responsibility for the oversight functions.

I do not argue that at all. We are simply trying to carry out the laws you prescribe. If there was ever anyone who is a believer in the supremacy of Congress, it is myself. Congress has to run for office. The members of the executive branch do not have to do that. You are talking to one person who thoroughly and has always believed in supremacy of the legislature.

Mr. DAN DANIEL. I did not mean to put it that way. Our situation is a little different from the executive branch. We have a purifying nature. If we do not carry our responsibility, well, I suppose you could say we are the most temporary employees in the Nation. We have the voter as a purifying agent.

I think Congress should take more responsibility rather than turning it over to regulators.

Admiral RICKOVER. Well, sir, if that is what Congress wants, that is what it will be. This is not the issue, as far as I am concerned.

Mr. DAN DANIEL. I am not sure Congress wants it. I am telling you what I think.

Admiral RICKOVER. Practically, I do not think, with the vast scope of this thing, that Congress can do the job itself. It would be overly burdensome.

Mr. DAN DANIEL. Before I came to Congress, I had the foolish notion that all of our problems were caused by the courts or by the executive branch in Government. I soon found out that was not the case. We have our faults, too.

We have many of our own problems. We should exercise that oversight responsibility to a greater degree than we do. If we do, I believe we can eliminate a lot of the other things that have caused so much trouble today.

Admiral RICKOVER. As far as I am concerned, from a philosophical standpoint, since Congress is the representatives of the people, I think that all sovereignty resides in you. We have no responsibility except for those you grant us. I thoroughly believe in that.

But you get into great difficulty when you have a country of 220 million people and try to run it as they did in the city-state of Athens, Greece where theoretically every voter could vote his desire. How are you going to do it practically?

You have to spend a lot of your time running for office.

Mr. DAN DANIEL. Mr. Stratton does not have any opposition this year. He can spend a lot of time doing this. He can spend more time on oversight.

In any event, we have the same objective.

Admiral RICKOVER. Yes, sir.

Mr. DAN DANIEL. I am opposed to passing laws and regulations. I deeply appreciate your comments.

Admiral RICKOVER. Thank you.

Mr. STRATTON. Mr. Price.

The CHAIRMAN. I will be very brief.

I certainly had no intent by any action I have taken in relation to amending the Vinson-Trammell Act to repeal the act. There is much ado about nothing.

The committee will come out with a sound answer and a good report. There is no reason for anyone to be in disagreement on it.

Admiral RICKOVER. I am very happy to hear that, sir.

The CHAIRMAN. Thank you.

Mr. STRATTON. Mr. Hopkins.

Mr. HOPKINS. Thank you, Mr. Chairman.

Admiral, we met briefly the other day, and we talked on the street if you recall. We welcome you to our committee.

Admiral RICKOVER. Yes sir, thank you, Mr. Hopkins.

Mr. HOPKINS. I have too much respect for you to even offer any kind of a debate at all with a man who has spent his entire life in the Navy. It is a life that we all owe so much to.

Let me ask you if you would, however, expand just a little bit. On page 6, you stated some shipbuilder officials profess to share the Navy's desire to keep contracts current and on a pay-as-you-go basis, but at the same time insist on loopholes.

Could you expand on that just a little bit for me?

Admiral RICKOVER. Yes. I can expand by giving you an example of what is going on today. We are in the process of making a contract for nuclear ships right now with the shipbuilders. We are proposing to put a limitation on the time which the shipbuilder shall have in order to submit a claim. They object.

Mr. HOPKINS. On what basis?

Admiral RICKOVER. For a very good reason. We want to make a contract with a limit of 9 months after an event happens for them to put in a claim. We are trying to comply with a request that we received from Mr. Price and the Armed Services Committee to avoid large after-the-fact claims.

The shipbuilders do not want to make a contract like this. They want to leave the issue open for a long time. I mentioned earlier that by leaving it open for a long time they can wait until the people who know what it is all about have gone; then submit a claim. Shipbuilders sometimes have a huge battery of lawyers and others whose sole job is to make everything that happens a claim.

Mr. HOPKINS. Who, for instance?

Admiral RICKOVER. I am sorry. I would rather not say that in public, sir. Nevertheless, I hope he changes his ways.

Mr. HOPKINS. That is all I have.

Admiral RICKOVER. There is a practical aspect to this. One proposal appears to be right. If you saw the actual workings of the shipyard and the large number of lawyers employed to push the claims on changes, you would be shocked.

It takes a great deal of our time that should be employed in technical matters. We have cases of shipyards run by managers who are gone 30 to 40 percent of the time.

Mr. HOPKINS. Why is that tolerated?

Admiral RICKOVER. What can we do about it? What can I do about this?

Mr. HOPKINS. Who is responsible for this?

Admiral RICKOVER. I would say the top of the corporation is because they apparently tolerate it. It is not necessary for the man to be there because his lawyers are running the company anyway.

As you know, lawyers are gradually taking over everything. I think you should subsidize law schools. We need a few more lawyers, and then you will not need any witnesses any more [Laughter.]

The CHAIRMAN. I have some statistics on lawyers and engineers which may inteerst the Admiral.

Lawyer graduates:	
1971	17,000
1980	35,000
Engineer graduates:	
1971	17,000
1980	17,000

Mr. HOPKINS. That is all I have. Thank you.

Admiral RICKOVER. That was a very cogent question you asked, sir. I was glad to have the opportunity to answer.

Do not think I am against the legal profession. I think we ought to have a few lawyers.

Mr. HOPKINS. I am not a lawyer.

Admiral RICKOVER. I appreciate that very much, sir. Thank you. [Laughter.]

Mr. HOPKINS. Thank you, Admiral.

Mr. STRATTON. Admiral, previously I had asked a witness to give us an idea of just what the Government might stand to lose if we were to have a 15-month moratorium in the application of the Vinson-Trammell Act. He said that he would try to compile that information.

You have included it in your statement on page 7. You said were Congress to excuse contractors from Vinson-Trammell for the period in question, some $200 billion of defense contracts would escape review.

Admiral RICKOVER. It would exempt it for 5 years, not 15 months. It is for the previous 5 years, from September 1976 when the Renegotiation Act expired through to fiscal 1981. That is 5 years. The 5 years was not when the Renegotiation Board stopped functioning.

Mr. STRATTON. I was figuring the time in which we would be able to reinstate it. You are right. The entire affected period is 5 years. You estimate that would involve some $200 billion.

Admiral RICKOVER. That is correct.

Mr. STRATTON. Of defense contracts.

Admiral RICKOVER. Yes, sir.

Mr. STRATTON. That is applicable to Mr. Price's statement where he said he does not want to repeal the Vinson-Trammell Act, but obviously there is going to be a big period involved here where we could be losing substantial revenues to the Government.

Admiral RICKOVER. Yes, sir.

Mr. STRATTON. Thank you very much. You have been very helpful, Admiral, and we appreciate your testimony.

Admiral RICKOVER. Thank you, Mr. Chairman.

I thank you and Mr. Price and the other members. I deeply appreciate the opportunity to appear before you. As you know, I so firmly

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believe that if there was ever a wonderful country which offers opportunities to everyone, it is this country.

I hate to see events which show we do not have the vision and the outlook that was exercised by our Founding Fathers. I think that sometimes we have to look back and see what the morality is of our actions and what impact it has on people.

I believe that is even more important than the money involved.

Thank you, sir.

Mr. STRATTON. Thank you, Admiral.

When we recessed for lunch, we had concluded with the testimony of Mr. Sheley, the GAO representative. Most of the other members of the committee were not present, so it is possible they might wish to interrogate you gentlemen.

If you could come back to the witness chair, I will try to summarize the points that you gave us, if that is all right with you. If I do not express them properly, you may correct me. Then some of the members may wish to ask questions.

The first main point was that you felt the Price proposal for a waiver of the Vinson-Trammell Act was better than the Senate proposal, because the Senate proposal put the termination date as of the completion of performance of the contract, which you said was a rather vague term. Lots of people could argue as to whether the contract was or was not subject to the waiver, whereas Mr. Price's bill sets the final period as the date of final payment, which is much easier to determine when you look at the date on the check.

The second main point was that you felt it would not be a good thing for the Government to have no constraint on excessive profits; that there should be some kind of a vehicle; although admittedly the Vinson-Trammell Act, as it now stands, leaves a good deal to be desired.

Third, you acknowledged that you are not an expert in legislative, parliamentary procedures. If the adoption of legislation that would waive this provision up until October 1, 1981, would mean it would be very difficult at that time to reinstate either that legislation or some other legislation, then you would be opposed to the idea of a waiver, in contrast to amending the existing legislation.

Maybe you might want to qualify some of those points. As I understood it, those were the three main ones.

Mr. SHELEY. About the only qualification, Mr. Chairman, I would have is in connection with the first point about our preference for this House bill as opposed to the Senate bill. It is that the House bill, by virtue of the final payment provision, would end up exempting fewer contracts in the event of new legislation or resumption of the Vinson-Trammell Act.

Mr. STRATTON. Have you any questions, Mr. Mollohan?

Mr. MOLLOHAN. No questions.

Mr. STRATTON. Mr. Robert Daniel?

Mr. ROBERT DANIEL. I have no questions.

Mr. STRATTON. Mr. Hopkins?

Mr. HOPKINS. No questions.

Mr. STRATTON. Mr. Price.

The CHAIRMAN. I have no questions.

Mr. STRATTON. I think you made your point.
Thank you very much.
Mr. SHELEY. Thank you.
Mr. STRATTON. Mr. Daniel, have you any questions?
Mr. DAN DANIEL. Yes.
What do you consider excess profits?
Mr. SHELEY. Anything in excess of 12 percent on an airplane contract or 10 percent on a ship contract can be deemed excess with respect to Vinson-Trammell's application. In reality, it has to be judged on the circumstances of each contract.
Mr. STRATTON. In connection with a question Mr. Robert Daniel asked Admiral Rickover, and he is the financier on the subcommittee and I am not very knowledgeable in that field, but does Vinson-Trammell in its present form define 15 percent of what?
Mr. SHELEY. Twelve percent for airplanes or 10 percent for ships based on the price of the contract.
Mr. STRATTON. Thank you very much.
Now we will hear from Deputy Under Secretary Dale Church of the Department of Defense, the Under Secretary for Acquisition Policy.
We will be happy to have your statement.
Mr. CHURCH. Good afternoon, Mr. Chairman.
I will not read my prepared statement, but I would like it submitted for the record.
Mr. STRATTON. Without objection.

STATEMENT OF DALE W. CHURCH, DEPUTY UNDER SECRETARY FOR ACQUISITION POLICY, DEPARTMENT OF DEFENSE

Mr. CHURCH. I am prepared to answer whatever questions you might like.
In all of the testimony of the witnesses today, as in the past, there is universal agreement that the Vinson-Trammell Act is outdated and not useful in the present world of defense contracts. The way I look at it, there are three alternatives: outright repeal of the Vinson-Trammell Act; amending the act in a manner which would be similar to the bill introduced by Congressman Patterson which we would support; or third, suspending the requirements of the Vinson-Trammell Act until such time as the Congress could decide which action should be taken.
Our preference is clearly to have the act amended at the present time. We have worked with Congressman Patterson and we have supported his bill in previous testimony.
The 60-month suspension of the Vinson-Trammell Act through fiscal 1981 would be far more preferable than seeing it implemented, however.
It has been asked a number of times today what the cost would be to implement the act. It is very difficult to estimate, but we believe it to be somewhat in excess of $100 million. It certainly would not be money well spent if the Congress subsequently amends the act to take into account some other provisions.
Nor do we believe the money recovered would be anywhere near $100 million.
Now, Chairman Price's bill, H.R. 7247, addresses the area of final payment made before October 1. This does not provide for subcontrac-

tors entering into subcontracts at this time, or those that have already entered into subcontracts any knowledge of whether or not their subcontracts have been or will be covered. They have no control over when final payment is made, and oftentimes it is very difficult to estimate when final payment will be made.

Often the negotiation of overhead rates can drag on from 3, 4, or 5 years after the essential performance of the contract is completed.

The other problem with respect to the final payment criterion is we have not been able to identify one single aircraft or shipbuilding contract, using the test of final payment, which would be suspended from the requirements of the Vinson-Trammell Act during the period indicated.

The Defense Authorization Act, recently reported out of the Senate Armed Services Committee, took a different approach. It based suspension on performance being completed. We agree with prior witnesses that performance being completed is probably even more indefinite than final payment.

*i*t will cause us a great deal of difficulty in trying to ascertain what constitutes completion of performance. Sometimes there are data items and deliverables that may stretch out many years after the major portion of the work is done, that is, the hardware has been delivered.

We know of no real definition of completion of performance. There, again, we do not believe there would be any prime contracts that would be suspended as a result of using that test.

Furthermore, it would create a great problem for subcontractors under these prime contracts, in ascertaining whether or not they are covered by Vinson-Trammell.

We have looked at this to try to ascertain what the Congress is trying to accomplish by the two proposals. If it is to suspend the act for contracts that are going on since 1976 and at the present time, we believe it would be a clearer test, and one that we could handle, to provide that any contract or subcontract that is performed using fiscal year 1981 or prior year appropriations would be exempt.

We can trace those appropriations, and where there are multiple appropriations, we could apportion out using the markup provisions or the going-in profit position to determine which portion of the profits would belong to 1981 and prior year funds.

We believe if in fact you wanted to suspend it, that that would be one that we could administer and give certainty to those entering into contracts as to whether or not Vinson-Trammell applies.

If there is concern by the committee that some funds may take years to get obligated, it would be very easy to include a date which is certain—which would say 1981 or prior year funds and obligated prior to whatever the date is.

In summary, say what we support is the approach of Congressman Patterson. If the Congress cannot fully consider this and other bills concerning profit limitations, we believe we will have to implement the Vinson-Trammell Act as is during this calendar year. We think that would be a disaster, a waste of the taxpayers' money.

We would then, if that is the alternative that we face, be willing to support a suspension.

Thank you, Mr. Chairman.

Mr. STRATTON. Thank you.

We are glad to have you. I understand the committee has made quite an extensive effort over a number of weeks to ascertain the view of the Department of Defense on various pieces of legislation relating to this subcommittee. There has been no answer forthcoming, including no response from a request of the chairman of the committee.

To try and pin you down, you have just said that you support the approach of Congressman Patterson. Now, we do not happen to deal with approaches in this committee or on the floor of the House. We deal with legislation. The question is: Do you support or do you not support H.R. 5433?

Mr. CHURCH. We do support it. To be very candid with you, the delay for getting out a report on that bill is the result of a clearance process. To my knowledge, it has not been finally cleared, although it has passed through the clearance process. I would have hoped it would have been cleared a long time before now.

I find no one who disagrees with me in support of H.R. 5433. I can say from the Defense Department viewpoint that the specific language in the Congressman's bill is, in fact, that which we would support.

Mr. STRATTON. Let me see if I understand what you are saying here. You said that you support Mr. Patterson's bill.

Mr. CHURCH. Yes.

Mr. STRATTON. You have objections both to Chairman Price's bill and to the Senate bill. Both of them are unsatisfactory, if I interpret this correctly, and you do offer some suggestions as to how Mr. Price might improve his legislation.

I thought you said there were three alternatives. Now, having brushed aside both of those bills, what other alternative is left?

Mr. CHURCH. The third was outright repeal, which we do not support.

Mr. STRATTON. You do not support repeal.

Mr. CHURCH. That is correct.

Mr. STRATTON. You share the view of the General Accounting Office that it would be unfortunate if we were not to have some legislation that could zero in on excessive profits and recover unreasonable profits.

Mr. CHURCH. We support the proposition and language of Congressman Patterson's bill. Some proposed alternatives are too indefinite. Clearly, the legislation as proposed in Congressman Patterson's bill is definitive and we do support it.

Mr. STRATTON. I do not know whether you would be the person to ask, because this is presumably a legal question but, if either one of the waiver bills were to be enacted, is it possible for the original legislation to be reinstated at the end of that period, which is October 1, 1981, without a positive action by the Congress?

Mr. CHURCH. I do not believe the Congress could go back retroactively once having suspending the act and reinstate it, or even put it in a different form of profit limitation. Once suspended, it stands suspended thereafter.

Mr. STRATTON. I am not one of those lawyers Admiral Rickover was talking about. So I am not sure we are on the same wavelength.

The chairman's bill does not suspend the act, as I understand it. It waives its provisions up until October 1, 1981. But I am concerned, if we pass that in an atmosphere of hoping to give the committee time to explore the entire subject and a feeling of goodwill with the Senate, that we may find on October 1, 1981, there is no more act; there is nothing to replace it.

It would seem to me that we are running a risk, that is, if you sincerely believe you need some such legislation. We are running a grave risk. We may end up with nothing.

Mr. CHURCH. What we believe would be the practical effect would be a 60-month or 5-year moratorium on the application of any profit limitation. You could not go back and apply any new legislation to those contracts covered by the moratorium. Any profit limitations that would be enacted would be prospective with respect to future contracts beyond that date.

Mr. STRATTON. Thank you.

Mr. CHURCH. Yes, sir.

Mr. STRATTON. We have a vote on the floor, and we will stand in recess for 10 minutes.

[Whereupon, a short recess was taken.]

Mr. STRATTON. The subcommittee will be in order.

Mr. Church?

Mr. CHURCH. I believe I was answering the wrong question or else I misunderstood it, as my learned colleague pointed out, and this was with regard to whether we use the word suspension or waiver. Chairman Price's bill says "shall not apply."

What was asked was what happened on October 1, 1981, when the "shall not apply" period runs out. The answer to that question is if nothing has been done with respect to the Vinson-Trammell Act, we will have the Vinson-Trammell Act in being again.

Otherwise, it would be whatever the Congress chooses to do with respect to amending the Vinson-Trammell Act, which would then be applicable from that day forward.

Mr. STRATTON. So under that language, the provisions of the Vinson-Trammell Act would become operative again on October 1 or October 2, whatever the date would be, without any positive action by the Congress?

Mr. CHURCH. If the Congress took no action, that is correct. The present act, or whatever amendment is adopted would be operable October 1, 1981.

Mr. STRATTON. I have a couple other questions.

Mr. CHURCH. Yes, sir.

Mr. STRATTON. On page 3, you suggested the language should be changed so that the contracts and subcontracts or any portion thereof that are performed utilizing fiscal year 1981 or prior year appropriations would be exempt.

Mr. CHURCH. Yes, sir.

Mr. STRATTON. Doesn't that present kind of an administrative nightmare? You would have a problem with bookkeeping and paperwork and so on.

Mr. CHURCH. We already have that problem. It would not add to our bookkeeping. We already have to account for our funds by fiscal

year. With respect to profits of contractors that are using 1982 or subsequent year appropriations, what we would do would simply be to take the portion which applies to the funds of 1981 and prior years, and we would apportion that out. This portion of the contract would not be subject to any profit limitations Congress may choose to enact for 1982 and subsequent years.

Mr. STRATTON. In a shipbuilding contract, for example, you are going to have a ship funded from appropriations over a period; is that right?

Mr. CHURCH. That is correct.

Mr. STRATTON. How can you apportion the profit and loss on just a portion of the contract?

Mr. CHURCH. You would not apportion the profit and loss. You would simply take that portion of the contract and say it is 10 percent of the funds were obligated against that contract in 1981 and 90 percent in 1982. You would simply deduct 10 percent and make it applicable to the remainder.

Mr. STRATTON. In effect, you would reduce the size of the contract?

Mr. CHURCH. You would reduce the amount of the contract that the 1982 and subsequent years' profit limitation would apply to.

Mr. STRATTON. I have one other question. If final payment by the prime contractor to the subcontractor were to be the criteria for the waiver of a subcontractor, would that remove your objection to H.R. 7247?

Mr. CHURCH. I think a businessman should have certainty when he goes into a contract as to what kind of limitation or regulations, et cetera, will apply to that contract. A contractor or subcontractor does not have control over when he will receive final payment. Oftentimes it is the result of a prime contractor not receiving his final payment for some reason that final payment cannot be made to a subcontractor.

So, again, things are without his control, and he would not be able, going into a contract now, to know if profit limitations would or would not apply. The choice that he has to make is like shooting dice. Your best guess is whether or not it will apply.

I do no think this is a burden that we should place on our contractors and subcontractors. I think they ought to know whether or not they are going to be covered by profit limitation.

Mr. STRATTON. Do you have a preference between Mr. Price's bill and the Senate legislation, if we go to the suspension; or do you favor neither of them?

Mr. CHURCH. If you are asking me to say which best meets the objective, I would have to better understand the objective.

If the objective is literally to place a moratorium in effect during the 60-month period that contractors will be working, then completion of performance goes furthest toward this. In the case of final payment, for example, we know of no prime contracts for ships or for aircraft that would be served by such a moratorium.

So as a consequence, if you are trying to suspend this with regard to those contracts, it does not accomplish that.

Our preference again, I would repeat, would be to amend the Vinson-Trammell Act to incorporate Congressman Patterson's bill and to do neither of the suspensions.

Mr. STRATTON. I am just interpreting here because the chairman did not consult me when he introduced the bill, but I assume the rationale is the contractors feel they have an unnecessarily high burden on them as a result of Vinson-Trammell and, as a practical matter for various reasons that we will explore in a moment, the Internal Revenue Service has done nothing to administer the legislation. They really are the ones administering it.

At the moment and in the foreseeable future, it is not going to go anywhere. Therefore, presumably Mr. Price feels we should get moving to come up with an alternative one like Mr. Patterson's bill. It is going to take us a little time. As long as the law is not being implemented anyway, we might as well turn it off.

Then when we come up with a better law that can be more successfully implemented, we could put that in.

Mr. CHURCH. What Chairman Price's bill would do would be to relieve us and the Internal Revenue Service of the burden of implementing Vinson-Trammell, as is, until such time as the Congress acted or October 1, 1981, whichever occurred first.

Mr. STRATTON. I think it is expected that, while you and I and Mr. Daniel might agree on how we could improve Vinson-Trammell, it would probably take until well into the 97th Congress before you could get a majority of both Houses to agree to that particular version.

Mr. CHURCH. That would be our observation as well. That is why, if Congressman Patterson's bill cannot be enacted, we do support the approach and the objective of relieving DOD and IRS of the responsibility of having to implement the act, as is.

Mr. STRATTON. But you would prefer the Price approach to the other approach?

Mr. CHURCH. I do not have a preference between those two.

Mr. STRATTON. You said Mr. Price's bill would not actually exempt anybody; whereas, the other one might exempt an indefinite number. Is that right?

Mr. CHURCH. I do not have an opinion on either of those. I think they accomplish two different things. I think as your technical witness on the matter I might point out what either of them might accomplish. You will have to choose from there.

Mr. STRATTON. You said you did not know of one contractor to which final payment had been made in the 5-year period. On how many contracts during the 5-year period has the performance been completed?

Mr. CHURCH. What we have here is a situation where if a contract was initiated prior to September 30, 1976, then they are not covered by this because they were in effect during the time that the Renegotiation Act suspended the Vinson-Trammell Act.

The contracts we are addressing are contracts that were started on October 1, 1976, or subsequent thereto. In that case, we do not know of any contracts in that group which either have received or which we would expect to receive final payment prior to October 1, 1981.

Mr. STRATTON. I know that, but what about performance completed? You must have had a contract with the XYZ Glove Co. in

New York for cold weather gloves to use when you invade Soviet Siberia. They probably whipped them up and sent them to you 2 years after you gave them the order. That would be a completed contract, would it not?

Mr. CHURCH. It would, but it probably would not involve ships or aircraft, which is all that Vinson-Trammell covers. It would not apply here.

The act only applies to ships and aircraft which take a long time to build. We would not expect that any of those would have received final payment. Although there would be a few aircraft that would be completed the final payment would probably not occur until some significant period of time after delivery of the aircraft itself.

Mr. STRATTON. Doesn't this apply to things that are attached to the aircraft or the ships?

Mr. CHURCH. Some of them, yes.

Mr. STRATTON. If you ordered 10 johns, would that be a separate contract or a subcontract for the main contractor on a 963-class destroyer?

Mr. CHURCH. It could be prime contract or subcontract. If it was going on the ship with its first outfitting and when it sails with its first outfitting, if it had the johns on it, they would be covered.

If the ship came back after its first sailing and they put the 10 johns on, they would not be covered.

Mr. STRATTON. The ship is tied up at the pier. It is getting outfitted. The contractor drives down from Schenectady, and he puts five of them on the deck. Then that does not count as performance completed?

Mr. CHURCH. No, they would have to be installed.

Mr. STRATTON. That shouldn't take long.

Thank you.

Mr. CHURCH. Yes, sir.

Mr. STRATTON. Mr. Dan Daniel?

Mr. DAN DANIEL. That is an indication of what I was talking about a moment ago with all the extra baggage we are burdening so many people with.

Now, Mr. Church, in light of the existence of the DOD contract and auditing operations, does the Department feel an adequate job is not being done to the extent that additional reporting is required?

Mr. CHURCH. An adequate job on what, sir?

Mr. DAN DANIEL. Contracting and auditing operations. They should cover this type of thing, it seems to me. If you are favoring some other approach, I think what you are saying is that they are not doing the job.

Mr. CHURCH. We are not allowed to do audits on fixed-price contracts for the purpose of determining final profits. If it is a fixed-price contract, we are simply not aware of what the final profit is.

In the case of a cost reimbursement contract, we will know what it is. We will pay out in accordance with the formulas and the regulations and the laws and the terms of the contract. All they do in the audits is provide us with information.

The audits are adequate to give us the data, except with respect to the fixed-price contracts, for which we get no post-performance data.

Mr. DAN DANIEL. Let's talk about that. Did you hear Mr. Minish's statement?

According to the DOD, only a fraction of the defense contracts use less than 15 percent or are awarded on the basis of price competition. Is that correct?

Mr. CHURCH. It depends on how you define "competition." There are as many definitions of "competition" as there are people. I am sure you could narrow the definition down in a way that you could derive that statistic.

Our statistic is, if I could quote from memory, a little less than 35 percent of our contracts which are awarded as a result of competition. Then there is an additional approximately 20 percent that would be follow-on contracts to those awarded by competition.

So we would have about 55 percent of our contracts overall which we would consider to be competitive contracts.

Mr. DAN DANIEL. And 30 percent of your prime contracts?

Mr. CHURCH. Prime contracts, that is what I am addressing.

Mr. DAN DANIEL. Did you say 60 percent?

Mr. CHURCH. About 55 percent would be considered in the area of competitive contracts.

Mr. DAN DANIEL. What about MIPR contracts? To what extent do you use that procedure?

Mr. CHURCH. For moving funds around?

Mr. DAN DANIEL. For buying equipment.

Mr. CHURCH. I must have missed your question.

Mr. DAN DANIEL. It would be a military or Interior or Department purchase request.

Mr. CHURCH. That is for moving funds from one element of the Defense Department to another element of the Defense Department.

Now, as far as the contracting procedure, it does not really affect it. We use the same procedures and same regulations and approaches whether it is done in one department or the other.

Mr. DAN DANIEL. Is this done frequently or infrequently? To what extent is that procedure used?

Mr. CHURCH. We might use it, say, where the Air Force buys an item needed by the Navy. They might move funds over, and the Air Force would do the whole buy. It might be the result of a joint program where all three of the services would contribute to a joint fund, which would then be done by the joint activity, a good example of which is the cruise missile or the joint cruise missile program office where all three of the services are contributing funds.

Mr. DAN DANIEL. How would these other contracts, the 30, 40 or 45 percent or whatever is left, be awarded?

Mr. CHURCH. They are awarded to the only known source of that particular material. A good example of that would be the Electric Boat Division of General Dynamics, which is the only one that has facilities to build the Trident missile.

Another example is the Newport News Shipyard, the division of Tenneco. They are the only one who can build a nuclear carrier at the present time.

Mr. DAN DANIEL. That clears it up in my mind. A lot of figures have been thrown around here today. One witness, I believe, said there is an estimated administrative cost to contractors of as much as $60 million per year, plus addition in-house cost to the Government of

as much as $40 million a year. I assume that means for the implementation of Vinson-Trammell.

Do you recognize those figures?

Mr. CHURCH. Yes.

Mr. DAN DANIEL. Is that the correct figure?

Mr. CHURCH. It is strictly an estimate. It is not one based on any data, since we have never done it before. It is our best guess that it would run in excess of $100 million to implement Vinson-Trammell.

Mr. DAN DANIEL. Can you give us an estimate of what that figure might buy in terms of recaptured profits?

Mr. CHURCH. Again, it would only be an estimate. Our calculations would indicate only a fraction of that investment would be returned in recovering the so-called "excess" profits.

Mr. DAN DANIEL. Thank you, Mr. Chairman.

Mr. STRATTON. I think that concludes your testimony. Thank you very much.

Mr. CHURCH. Thank you, Mr. Chairman.

WRITTEN STATEMENT BY DALE W. CHURCH

Mr. Chairman and Members of the Committee:

I am pleased to present to you today the views of the Department of Defense concerning legislation which would waive the applicability of the Vinson-Trammell Act during the five-year period October 1, 1976, through September 30, 1981.

THE NEED FOR LEGISLATIVE ACTION ON THE VINSON-TRAMMELL ACT

There is almost universal agreement that the Vinson-Trammell Act (Sections 2382 and 7309 of Title 10 U.S.C.) is an outdated statute that should not be implemented. The Department of Defense has previously stated that implementation of the Act would be costly, imprudent, and could seriously affect the industrial base necessary for the defense of this nation. At this point, however, the Departments of Treasury and Defense have no alternative other than to proceed with its implementation. We have recommended that this antiquated and flawed statute be replaced with one that is reasonable, workable, cost effective, and which would meet the public policy need for profit limitation on defense contracts.

While the Department of Defense would prefer that Congress consider the bill introduced by Congressman Jerry Patterson (H.R. 5433), we can appreciate the fact that there may not be time to fully consider the various alternatives to the Vinson-Trammell Act during this session.

We have concluded that in the event substitute legislation cannot be enacted, a suspension of the provisions of the Vinson-Trammell Act through the end of Fiscal Year 1981 would be far more preferable than seeing the Act implemented. We believe that any attempt to retroactively apply the provsions of the Vinson-Trammell Act back to October 1, 1976, would be almost impossible. We note that the bill introduced by Congressman Patterson contains a provision which would suspend the provisions of the Act from October 1, 1976, until 120 days after enactment of his bill.

DOD COMMENTS ON H.R. 7247

The Chairman's letter to the Secretary of Defense asked that the Department of Defense presents its views on H.R. 7247. This bill provides that the Vinson-Trammell Act would not apply with respect to any contract or subcontract on which final payment is made before October 1, 1981. While we agree that suspension of the Act is desirable, it is our view that the provision in the bill making the suspension depend upon final payment is unworkable. Such a provision would place a contractor or subcontractor in a position of not knowing at the outset whether the contract or subcontract would be subject to the Act or superseding legislation. Final payment can depend on a number of factors which are external to the performance of the contract. For example there may be an excusable delay which could extend final payment beyond this statutory date or there

could be a dispute or claim arise during or after contract performance which could delay final payment.

You also asked that we provide our views on a similar suspension provision in the Defense Authorization Act, which was recently reported out of the Senate Armed Services Committee. This provision would suspend the Vinson-Trammell Act during this same period, however, suspension would be based upon completion of performance prior to October 1, 1981, as opposed to final payment. We do not believe that a provision of this nature would be workable for the same basic reasons as we objected to the provision in H.R. 7247. Additionally, the definition of completed performance has been a long-standing issue in the administration of the Vinson-Trammell Act. There is disagreement over whether performance should be considered complete for purposes of the Act when the last aircraft or ship has been delivered or, alternatively, when all work contemplated by the contract has been accomplished. Contracts frequently require work subsequent to delivery of the last ship or aircraft.

RECOMMENDED REVISIONS TO H.R. 7247

It is our understanding that the intent of H.R. 7247 is to not suspend the Vinson-Trammell Act for certain large, long term contracts, the performance of which may extend beyond Fiscal Year 1981. If this is the case, it is our view that the language in H.R. 7247 should be changed to provide that the part of any contract or subcontract that is performed utilizing Fiscal Year 1981 or prior year appropriations would be exempt from the Vinson-Trammell Act. This language would assure that contracts that are incrementally funded, or are changed or modified to add new or additional work using Fiscal Year 1982 or later appropriations would not be totally exempt from the requirements of the Act, or any superseding statute, by virtue of being awarded during the five-year suspension period.

That concludes my prepared statement. I would be happy to answer any questions you may have on this subject.

Mr. STRATTON. We have a quorum call and a vote on the floor at the moment. We are going to have to recess again.

I apologize to our witnesses for keeping them so long, but we have just one other Government witness, that is, Mr. Philip Coates, the Assistant Commissioner of the Internal Revenue Service. Then we have five representatives from industry.

Perhaps the quickest way to handle this would be for Mr. Daniel and me to return after the vote and to hear the testimony of the IRS gentleman. Then we will have the five industry witnesses at the table together. They can read their statements and we can ask questions of all of them.

They have been very patient while a lot of people have been abusing industry. So we will give them their chance to get back.

If you will excuse us, we will stand in recess for 10 minutes.

[Whereupon, a short recess was taken.]

Mr. STRATTON. The subcommittee will come to order.

Our next witness is Mr. Philip Coates, Assistant Commissioner for Compliance of the Internal Revenue Service.

Mr. Coates, we appreciate having your testimony at this time.

Mr. COATES. Thank you for the invitation. We previously submitted an opening statement to become part of the record.

In the interest of time, I think I will dispense with reviewing the first two pages, and I will pick it up at the bottom of the second page.

Mr. STRATTON. Your complete statement will be included in the record, without objection.

STATEMENT OF PHILIP E. COATES, ASSISTANT COMMISSIONER FOR COMPLIANCE, INTERNAL REVENUE SERVICE

Mr. COATES. I have done some improvising to the opening statement to accommodate some of the questions that have been raised here today, and I will cover those as I cover the balance of the opening statement.

It is generally agreed that the existing act is antiquated. Administration of the act by the Internal Revenue Service could be costly, could require extensive training of our agents in new areas, and would result in the diversion of scarce tax administration resources to a non-tax function.

In considering the possible alternatives to the act, we hope Congress will seriously consider the costs of involving the Internal Revenue Service at all in the procurement area, diverting the Service from its basic tax administration mission.

If there are to be legislative changes to the act, we hope they will occur before we incur the further significant costs of implementing the existing law.

Here I will digress from my opening statement as given to the committee.

We have been asked to comment on two specific proposals to suspend the Vinson-Trammell Act. We do not express any view on whether contractors should be relieved from liability during any suspension period. Any bill suspending the act should, however, make it clear that it defers the reporting requirements for all contracts during the suspension period.

H.R. 7247 would suspend application of the Vinson-Trammell Act with respect to all contracts for which final payment is made or scheduled to be made before October 1, 1981, and all subcontracts under those contracts. Under this formulation, it would appear that the only subcontracts for which the act would be suspended are those under prime contracts for which final payment is made before October 1, 1981.

Also, we are concerned that there may be contracts or subcontracts that have been or will be completed before October 1, 1981, and it is now known that final payments will not be made until after October 1, 1981. The Service would, therefore, be required to administer the act currently for many subcontracts.

If Congress eventuallly repeals the act retroactively or substantially modifies it to exclude the Service's administrative role, this current enforcement would be a nonproductive use of our resources.

For these reasons, we suggest the bill be clarified that no reports be filed before October 1, 1981. In this regard, we do not object to the final payment language of H.R. 7247 if it were clarified to defer the reporting requirements for all contracts completed before October 1, 1981.

The Senate Armed Services Committee has approved, as a rider to the Defense authorization bill, a provision which would suspend the act's application to all contracts and subcontracts where performance is completed by October 1, 1981. The Senate bill would thus suspend the Vinson-Trammell Act for all contracts completed before October 1, 1981. The act would be suspended for subcontracts

completed by this date without regard to when the prime contract is completed.

Although this formulation may contain ambiguities that would present problems of administration if the act were to become effective on October 1, 1981, such as determining which contracts were completed by that date, the Senate bill would effectively eliminate any need for administering the act before October of next year.

This concludes my prepared statement, Mr. Chairman. I will be pleased to answer any questions.

Mr. STRATTON. I wonder if you could fill in again the additional wording you had on page 3, following the end of that page, as to the current enforcement which would be a nonproductive use of our resources and so on.

Mr. COATES. I said:

> For these reasons we suggest that the bill be clarified that no reports be filed before October 1, 1981. In this regard, we do not object to the final payment language of H.R. 7247, if it were clarified to defer the reporting requirements for all contracts completed before October 1, 1981.

Mr. STRATTON. The payment requirement for all contracts? Could you repeat that?

Mr. COATES. "To defer reporting requirements for all contracts completed before October 1, 1981." Now, Mr. Chairman, we can revise the opening statement along the lines that I read, if you like.

Mr. STRATTON. Just so we could have it for the record. That would be helpful.

How did the IRS get into this act in the first place? Is that spelled out in the initial Vinson-Trammell legislation?

Mr. COATES. We have the administration requirements of the act under the legislation, although for many, many years there were no administrative requirements of the Vinson-Trammell Act because of the Renegotiation Act. We found ourselves with administrative requirements, I guess, in September of 1976, which was when the Renegotiation Act expired.

We did not move hastily to get ourselves involved in the administration at that time, being mindful of the fact that in the past there had been some retroactive extensions of the act and of the Renegotiation Act.

We are also mindful of the fact that we have no expertise in this area whatsoever. I am speaking now of expertise with respect to the Defense Department.

Mr. STRATTON. The Renegotiation Board did not come in until after World War II, did it?

Mr. COATES. Prior to World War II, Mr. Chairman.

Mr. STRATTON. You said prior?

Mr. COATES. Just a moment, sir. The act was passed in 1934. The profit——

Mr. STRATTON. You had the excess profits extended in 1940, during World War II.

Mr. COATES. Yes, to January 1, of 1947, during the existence of the old excess profits tax.

Mr. STRATTON. Somebody must have administered it between 1934 and 1940.

Mr. COATES. Yes, sir. I am not sure how many are still around in 1976 from the 1940 administrators.

Mr. STRATTON. There should be some record in IRS as to just how they handled it.

Mr. COATES. You know, Mr. Chairman, there were regulations on Vinson-Trammell since 1939. Those are the regulations that we had at the time.

In 1976, when we again found ourselves with the responsibility for administering the act, we found that those regulations were pretty much antiquated and almost unworkable. We subsequently made the decision that we had to initiate a whole new regulation writing procedure and pretty much discard the regulations. That was a judgment that we made.

Mr. STRATTON. What do you regard as the problems in implementing the legislation at the present time? Is the percentage rate unrealistic? Is the eligibility, the $10,000, unrealistic?

Mr. COATES. No, sir.

Mr. STRATTON. Are there other problems involved as well?

Mr. COATES. We would not have a position on that. We do not view the 10 or 12 percent or the threshold amount as making the act unworkable or unadministerable as far as the Service is concerned.

Our principal concern at this time is that we have no expertise in this area. We would have to divert resources from our mainstream mission of tax administration into the administration of Vinson-Trammell.

I do not want to infer that we are not taking steps to administer the act. We are moving right along with our regulation project at the present time. The proposed regulations have been promulgated, they have been published, and there have been hearings. We are in the process now of discussing with the Department of Defense those regulations.

Even though we are on extension until October of this year, we are continuing to work toward that deadline. Certainly, I doubt that we will make that deadine. But I do not think it will be another 6 months after that time.

Mr. STRATTON. So the major objection is simply that you do not have the personnel to handle this size project?

Mr. COATES. Yes, in addition to not having the expertise.

Mr. STRATTON. Admiral Rickover said he hoped we did not turn it over to the Department of Defense. Do you have anybody else who might be eligible?

Mr. COATES. No, sir, I would not have any thoughts on that.

Mr. STRATTON. Your point with respect to the reporting requirements, I think, does seem to make some sense. Under either one of these programs, we almost have to wait until October 1 to really be sure who is and who is not eligible. Therefore, you suggest that until October 1 has come and gone, you cannot determine who is eligible for exemption and who would have to be covered.

Therefore, the reports would not need to be in until after October 1.

Mr. COATES. That's correct.

Mr. STRATTON. This is in both the Senate and the House bills.

Mr. COATES. Yes. If that is clarified in the House bill, certainly we would have no objection to the House bill. We do not want to find our-

selves in the posture of having to administer the Vinson-Trammell Act during this period. That is the way we have been reading the House bill—that we would still have a responsibility to administer the act during the suspension period.

If there is no reporting, we feel we do not have that problem.

Mr. STRATTON. They say the Senate bill may contain some ambiguities that would present problems of administration.

Mr. COATES. Yes, sir.

Mr. STRATTON. So I take it that if the House measure, which is before us, were amended to include the statement that no reports would be needed until after October 1, 1981, you would prefer that wording to the Senate version?

Mr. COATES. Yes, sir. That would be completely satisfactory to us.

Mr. STRATTON. Mr. Dan Daniel.

Mr. DAN DANIEL. Mr. Coates, what is your estimate as to the cost of the IRS implementation of Vinson-Trammell?

Mr COATES. We do not really know. I guess it will depend a whole lot on what the final determination of the Congress is on reporting requirements and what the threshold would be on the requirements. We would not know how many reports would be filed as of now or how many we would have the responsibility for administering.

I guess as we do in tax administration, obviously we do not examine 100 percent of the returns filed. Now, whether or not there would be some latitude on a percentage coverage of examination or audit of the reports—today obviously our coverage on high-income returns is much higher than low-income returns, and I would assume there would be some judgment exercised as to the extent of the coverage.

Mr. DAN DANIEL. You do not know what the requirements would be?

Mr. COATES. We have not made a judgment as to what would be required. It would depend a whole lot on the legislation and the number of reports that would have to be filed and whether or not there would be any question about the amount of coverage and examination.

Mr. DAN DANIEL. If you are required to implement Vinson-Trammell, when would you be ready for it?

Mr. COATES. To administer it?

Mr. DAN DANIEL. Yes.

Mr. COATES. We would be ready to administer it once we have the final regulations and have them published and give contractors sufficient lead time to get themselves ready to make their reporting. I would assume that while this is all taking place that we would be doing the necessary training and getting our people ready to make the examinations.

I would say—well, I cannot say with certainty—but I would say within 1 year we could do it. Obviously, if we find ourselves with the responsibility for administering Vinson-Trammell after October 1981 and we know in advance, that is a key point, then we can take the necessary steps to do the training.

Also, we would recognize the impact on our main function of tax administration.

Mr. DAN DANIEL. Does somebody else have any additional comment?

Mr. COATES. On our final regulations, before they become final and are published, the Defense Department has to agree on those. The time would not be completely within our control. That is another reason I speak with a little bit of uncertainty.

Mr. DAN DANIEL. It could be 2 years or any number of years.

Mr. Stratton may have asked you this, and it may be in your testimony, and I apologize for not having read it, but you notice we have been in and out all day today.

What has been the chief stumbling block to promulgating these regulations?

Mr. COATES. In the beginning, we had existing regulations that dated back to 1939. We made a judgment after the act expired that those regulations were too antiquated to work with. They needed so much revision that a decision was made that we would go to writing completely new regulations.

At the same time, we did not know the status of the act during that period, whether or not there might be a retroactive extension of the act, as had happened in the past.

The real problem, I guess, is that we waited until we were relatively sure that we had an act to administer. Then we began to write the regulations. Within 1½ years after the act expired, we were moving along pretty good on the regulation writing.

We are still moving along. They have been published. We have had public hearings. We are in the process of finalizing; after clearance with the Department of Defense, we hope to eventually publish the final regulations under Vinson-Trammell.

Mr. DAN DANIEL. Thank you.

Mr. COATES. Yes, sir.

Mr. STRATTON. I may not understand this clearly, but I understood you to say you have drawn up the regulations. You are in the process of promulgating them now.

Mr. COATES. The proposed regulations, Mr. Chairman, have been published. We have received comments. There have been public hearings on the proposed regulations under Vinson-Trammell. The public hearings were in March of this year. The proposed regs came out last October. The hearings were this past March.

Mr. STRATTON. OK. It would not take long before those hearing would be firmed up or, that is, those proposed regulations would be firmed up; is that right?

Mr. COATES. We are in the process now of so-called firming up. This means taking into consideration the comments that were made at the public hearings and the comments that came in the statements. Eventually we will need the agreement of the Defense Department before they can ultimately be finalized.

Mr. STRATTON. Presumably, this would be completed sometime toward the end of this year.

Mr. COATES. Yes, sir.

Mr. STRATTON. Then you would send them out to industry?

Mr. COATES. We would publish them.

Mr. STRATTON. Assuming that there was no waiver.

Mr. COATES. Yes.

Mr. STRATTON. Since this is a question of calendar years, then why do you need a waiver? In other words, if there were no waiver, you

would have promulgated the regulations; when the businesses file their tax returns, you have your information, have you not?

Mr. COATES. Except I think we would be obligated after publishing to give a reasonable amount of time for those who had reporting requirements to gear up and be ready in terms of having sufficient information and records to report.

Mr. STRATTON. The reporting would be done on April 15; or would it be done quarterly or what?

Mr. COATES. I think the statute, Mr. Chairman, requires that the reporting requirement is 8½ months after the end of the year in which the contract is completed. I will look to one of my colleagues to make sure that is correct.

Yes; it would be 8½ months.

Mr. BROWN. What would happen is that when the regulations are finalized, they would apply to taxable years ending after September 30, 1976. Returns would be required to be filed with respect to any contracts completed during the period October 1 through taxable years ending at least 8½ months before the filing date. We expect that the filing date will be a month or two after the finalized regulations are published.

You should understand—and I think it was pointed out earlier—that any contract that was subject to renegotiation is not subject to Vinson-Trammell even though that contract might not be completed until after September 30, 1976.

Mr. STRATTON. Thank you.

As I understand it, the Internal Revenue Service is one of the strongest supporters of a waiver so that you would get out from under this job. I can see where you might not want to do it, but it does not appear, on the surface at least, to be too burdensome; you are that far along on it.

Mr. COATES. We do not know how burdensome it would be in terms of what the total obligation would be for resources. I think I would be remiss if I did not mention that we would be very concerned about having to gear up and administer the act of Vinson-Trammell for 1 year if there is a possibility there would be some substantial revision as of October 1, 1981.

As I pointed out, we still do not have that expertise, and it would be a major training undertaking to select and train the people. If it is just for a period of 1 year, I would question the use of the resources.

Mr. STRATTON. We have an unemployment problem. We have the CETA organization. We could give you CETA employees to do it.

You have heard the testimony this morning that these regulations, at least as far as the Renegotiation Board was concerned, were so burdensome that industry had to spend something like $280 million a year in order to comply with the various reports that were required. Would you say that the regulations you are proposing and are in the process of developing would place anything like that kind of burden on industry?

Mr. COATES. Mr. Chairman, it is difficult for me to determine what the burden would be and the cost of the companies who would have a reporting requirement. I just do not have a feel for it. There would be regular recordkeeping requirements as with this tax law or any other law that requires reporting.

Mr. Dan Daniel. I have no futher questions. Thank you.

Mr. Stratton. I think that about covers it. Thank you very much for your testimony and for the information. If we have any other technical questions we may have the staff get back to you.

Mr. Coates. Feel free to do so. Thank you.

Written Statement of Philip E. Coates

Mr. Chairman and Members of the Subcommittee, I appreciate this opportunity to discuss the administration of the Vinson-Trammell Act and H.R. 7247.

Under the Vinson-Trammell Act, the Treasury Department is responsible for the collection of any excess profits on Government contracts for the construction of naval vessels and military aircraft or portions thereof. Excess profits are defined for purposes of the Act as profits in excess of 10 percent of the final contract price on contracts for naval vessels or portions thereof, and in excess of 12 percent of the final contract price on contracts for aircraft or portions thereof. Contracts are subject to the Act if they involve a contract price of $10,000 or more.

The Act was passed in 1934. The profit limitations in the Act were suspended October 8, 1940 to January 1, 1946, during the existence of the Excess Profits Tax. These limitations were again suspended by the Renegotiation Acts of 1948 and 1951. Upon expiration of the Renegotiation Act of 1951 on September 30, 1976, the profit limitation provisions of Vinson-Trammell came back into effect. Thus, except for the approximately two and one-half years from January, 1946 to May, 1948, the Vinson-Trammell provisions were suspended for the 36-year period of October 8, 1940 through September 30, 1976.

The existing regulations under the Act require that applicable reports be filed within eight and one-half months after the end of a taxpayer's taxable year. Since the Act has again been in effect, the Internal Revenue Service has repeatedly extended the due dates of the reports. During this period, the Treasury Department and Defense Department have worked to update the existing regulations under the Act.

Last October, the Treasury Department published proposed regulations. In December, the Department of Defense also published proposed rules and a reporting form and requested comments on two aspects of Treasury's proposals. A hearing on the proposed Treasury regulations was held on March 12, 1980. Representatives of the Treasury Department and Defense Department are working to resolve differences and adopt final regulations.

It is generally agreed that the existing Act is antiquated. Administration of the Act by the Internal Revenue could be costly, could require extensive training of our agents in new areas, and would result in the diversion of scarce tax administration resources to a non-tax function.

In considering the possible alternatives to the Act, we hope Congress will seriously consider the costs of involving the Internal Revenue Service at all in the procurement area, diverting the Service from its basic tax administration mission.

If there are to be legislative changes to the Act, we hope they will occur before we incur the further significant costs of implementing the existing law.

H.R. 7247 would suspend application of the Vinson-Trammell Act with respect to all contracts for which final payment is made or scheduled to be made before October 1, 1981, and all subcontracts under those contracts. Under this formulation, it would appear that the only subcontracts for which the Act would be suspended are those under prime contracts for which final payment is made before October 1, 1981.

The Service would, therefore, be required to administer the Act currently for many subcontracts. If Congress eventually repeals the Act retroactively or substantially modifies it to exclude the Service's administrative role, this current enforcement would be a non-productive use of our resources.

The Senate Armed Services Committee has approved, as a rider to the defense authorization bill, a provision which would suspend the Act's application to all contracts and subcontracts where performance is completed by October 1, 1981.

The Senate bill would thus suspend the Vinson-Trammell Act for all contracts completed before October 1, 1981; the Act would be suspended for subcontracts completed by this date without regard to when the prime contract is completed. Although this formulation may contain ambiguities that would present problems of administration if the Act were to become effective on October 1, 1981, such as

determining which contracts were "completed" by that date, the Senate bill would effectively eliminate any need for administering the Act before October of next year.

This concludes my prepared statement. I will be pleased to answer any questions you may have.

Mr. STRATTON. Our final witnesses are those from industry. It might be simpler if all five of them could be seated at the table. Then we will take their statements individually, which I understand are brief.

We have Dr. Karl Harr, president of the Aerospace Industries Association of America; we have Mr. Peter McCloskey, president of the Electronics Industries Association; Mr. Edwin Hood, president of the Shipbuilders Council of America; Mr. Charles Stewart, president of the Machinery and Allied Products Institute; and Mr. Bruce Hahn, of the Alliance of Metalworking Industries.

You may present your statement.

Mr. HARR. I have a very brief statement, but I think with your permission I will submit it for the record.

Mr. STRATTON. It may be included in the record.

STATEMENT OF KARL G. HARR, JR., PRESIDENT, AEROSPACE INDUSTRIES ASSOCIATION OF AMERICA, INC.

Mr. HARR. With me is Mr. Dunnuck of the Boeing Co. He is intimately familiar with the task of coping with matters of this type, including the Vinson-Trammell reporting requirements. He will be available for questions, should you have any.

Obviously our problem is that we do not think the Vinson-Trammell Act is salvageable in any way, shape or form, and that the various groups which look at it from whatever angle have all come to that same conclusion.

The problem that faces this committee—and which I believe is embodied in the language of the chairman's legislation—is: How to cope with a 5-year period during which time the Vinson-Trammell Act has theoretically been in effect, but for which the IRS has been unable to devise satisfactory implementing regulations?

I would agree with the IRS that their degree of expertise in the procurement area is not the same as their degree of expertise in their main mission. I do not intend to be facetious or pejorative in saying that. I submit that the problem is not can the IRS come up with some sort of regulations for implementing the act, but whether those regulations or the act under which they are issued are, in fact, equitable or workable.

We think all of the testimony here and on the Senate side before the Morgan committee demonstrates that this will not be possible.

So with the selection of a date in the future, October 1, 1981, as a possible time by which both Houses of Congress could come to grips with the major question of what, if any, kind of profit limitation legislation is the most appropriate one for this country at this time, the practical problem becomes: What do we do in the interim?

While the affected companies are presently relieved by a 6-month extension of the deadline for issuing regulations, they must still be prepared to respond to reporting requirements and to comment on the proposed regulations. It is burdensome for some of the big companies. It is a counterproductive drop in the bucket.

For smaller companies, it gets to be a real hassle. It is a tremendous addition to their burden.

So the question is: Should there be a moratorium on reporting requirements to relieve IRS of the task it does not want? And even if the IRS could, eventually, issue implementing regulations, we believe that they would be questionable in nature and a burdensome requirement, the cost of which will be passed on to the taxpayer.

Congress has to decide whether it is the Patterson bill or the McCloskey bill that is the way to go. If there should be a moratorium, and we strongly suggest that all of the facts point in that direction, the question is which of the two proposed avenues—the Price bill or the Senate amendment language—is the better one.

We support both of them. We prefer the Senate language which would eliminate reporting requirements until the date of October 1, 1981; this would solve the problem as viewed from the industry side.

Our comments on various pieces of profit limiting legislation will be cheerfully offered for consideration by this Congress or the next. But at this time, we do not think that this is the issue at hand.

This subcommittee is presently studying the very narrow issue of the Price and Morgan versions of a proposed moratorium. I should have said at the outset, and I [illegible] in closing, I am representing the major builders of aircraft, spacecraft, missiles and related components and equipment.

Thank you.

WRITTEN STATEMENT OF KARL G. HARR, JR.

Mr. Chairman and Members of the Subcommittee:

I am Karl G. Harr, Jr., president of the Aerospace Industries Association of America, Inc., the national trade association representing the nation's major manufacturers of aircraft, spacecraft, missiles and related components and equipment. With me is Everett M. Dunnuck, Assistant Controller, Corporate, of the Boeing Company. As primary suppliers of advanced defense and space systems, we appreciate the opportunity to participate in these hearings and express our views on H.R. 7247, which would defer application of the Vinson-Trammell Act until October 1, 1981. As you know, the Senate Armed Services Committee has also acted in this regard.

Although, in our opinion, the Vinson-Trammell Act should be repealed outright as an inequitable, obsolete, and completely unworkable statute, we fully support Congressional action to suspend implementation of the Act in its present form, pending the opportunity to study the need for any profit-limiting legislation for defense contracting.

On October 1, 1976, with the expiration of the Renegotiation Act, the Vinson-Trammell Act became the law of the land. Since that time the Association has actively followed and participated in deliberations of the Department of Defense, the Internal Revenue Service and the Congress directed at implementing the requirements of the Act and other related matters. We believe that these proceedings, as well as the hearings conducted by Senator Morgan's Subcommittee on Procurement Policy and Reprogramming of the Senate Armed Services Committee, reveal the unanimous view that the Vinson-Trammell Act is totally outdated and unworkable in today's procurement environment. In addition, the DOD estimates that the administrative cost to small and large contractors could run as high as $80 million a year. When coupled with Government in-house costs, including an additional 1500 IRS employees to administer the Act, the total yearly cost from all sources could be as much as $120 million.

In our opinion, such costs will be materially in excess of any possible monetary recoupment by the Government under the provisions of the Act. Coupled with other significant implications which may result from its implementation,

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such as the erosion of the industrial base by the withdrawal from such base of many key small business suppliers, there is an urgent and immediate need for Congress to take action to preclude implementation of the Vinson-Trammell Act at the present time.

Accordingly, as I said at the outset, we support immediate action to defer implementation of Vinson-Trammell until October 1, 1981. Frankly, of the two proposals, House and Senate, which have thus far been advanced, we prefer the wording of the Senate bill because it relieves contractors of any obligation to report during the five-year period and precludes the issuance of any implementing regulations which would be effective before October 1, 1981. The latter, as contractors are all too aware from the experience of the past three years, require time-consuming and expensive responses and are an added burden in the procurement process which could be dispensed with pending final Congressional disposition of this matter.

In sum, while we prefer the Senate language to the House, we stand ready to contribute in any way we can.

That concludes my comments, Mr. Chairman. I will now try to answer any questions you might have.

Mr. STRATTON. Now we will hear from Mr. McCloskey.

STATEMENT OF PETER F. McCLOSKEY, ELECTRONICS INDUSTRIES ASSOCIATION

Mr. MCCLOSKEY. You have already heard from Paul McCloskey I can understand why he likes to be called "Pete."

I would like to address my comments, specifically, toward two points encompassed in the Senate and the House versions of the proposed bill.

The Senate version of H.R. 7247 provides that subcontracts completed prior to October 1, 1981 would be subject to the exemption of the Vinson-Trammell Act. The House version does not do this. It makes exemption dependent upon the prime contract having had final payment prior to October 1, 1981.

The real issue is what is the purpose of this exemption or waiver of the Vinson-Trammell Act. If the purpose is because DOD or IRS or industry are heavily burdened at this time, while Congress reexamines the issue of what type of profit limitation ought to be applicable to defense contracts, then neither bill, as pointed out by Mr. Church, provides that relief.

Both the House and Senate versions provide relief to DOD and IRS, but they do not provide any relief whatsoever to the contractor, particularly the House version, because the contractor or the subcontractor does not know whether his prime contract is going to be finally paid or not prior to October 1, 1981.

If you can envision the situation for a contractor; he does not know when he enters a contract today, whether or not he is going to be subject to the reporting requirements of Vinson-Trammell. Consequently, that is an additional element of cost for him to consider.

EIA considers it an unrealistic burden particularly for small subcontractors in the electronic business. What is required for them is to understand where their product is going. Should they sell, for instance, a lot of semiconductors to a prime contractor, that contractor can put it in his inventory for placement either into a ship radio or an aircraft radio. In the former case he is subject to a 10-percent limitation, and in the latter a 12-percent limitation. This subcontracter also may have additionally sold some of the same lot to commercial contractors,

thereby creating a very unrealistic situation. This is precisely what we are concerned about.

The laws of Vinson-Trammell are archaic. I think if we are going to suspend their operation, we should suspend it for this entire period of time.

The two points I would like to make regarding the Senate and House versions are; subcontracts should be treated equally with contracts and the final payment or performance completion criterion is really a question of how wide a window Congress wants to open for the period of time in the exemption. A final payment criterion will be a considerably narrower window.

If I understood Mr. Church correctly, he does not know of any contracts that have fallen into this final payment window and under performance completion criterion, there still exists a major question as to how many contracts will be involved, particularly if you have the subcontract provision.

Mr. Chairman, I thank you. I represent the Electronic Industries Association and I am pleased to be here on their behalf. I will answer any questions you may have.

Mr. STRATTON. Your complete statement will be inserted in the record.

WRITTEN STATEMENT OF PETER F. MCCLOSKEY

Mr. Chairman, my name is Peter McCloskey and I am President of the Electronic Industries Association (EIA). EIA is the major national organization representing the electronic manufacturers of the United States. Our 350 companies range from manufacturers of the smallest electronic part to major corporations that design and produce the most sophisticated and complex systems used in the nation's defense and space programs, as well as for commercial use in a variety of areas. EIA member companies account for over three-quarters of the $81 billion electronic market, and are responsible for the employment of nearly 1.4 million Americans.

I appreciate the opportunity to appear before this subcommittee and comment upon H.R. 7247 designed to limit the applicability of sections 2382 and 7300 of Title 10, United States Code to contracts for the construction or manufacture of military aircraft or naval vessels. Due to the number of EIA member companies engaged in defense contracting, H.R. 7247 and its related subjects are of obvious concern because electronics plays such an extensive role in defense systems.

While our industry's overall position is supportive of an outright repeal of the unworkable and archaic Vinson-Trammell Act and systems of profit limitation, we are supportive of a rational compromise approach similar to that which Mr. Price's H.R. 7247 is based upon. Notwithstanding any contracts prior to October 1, 1976 which may have remotely been under the jurisdiction of Vinson-Trammell, a retroactive limit of Vinson-Trammell applicability for contracts completed prior to October 1, 1981 is beneficial and supported. It would rightly allow Congress time to reconsider the entire concept of profit limitation and, specifically, the Vinson-Trammell Act. However, our support for the basic concept of a retroactive limitation of applicability and this limit's implementation are different issues. It is to the question of implementation that our concern is raised.

H.R. 7247 does not clearly delineate treatment for contracts and subcontracts. EIA believes that the coverage for subcontracts should be addressed equally with contracts, thereby, allowing subcontracts to stand on their own under this Vinson-Trammell exemption. The word subcontract should be positioned within the language of the bill in order to facilitate this substantive equalization. The placement of the phrase "or subcontract" after the term contract in the bill's description, line 4 of page 1, and line 1 of page 2 would correct this inequality. resultantly, the phrase "or to any subcontract of such a contract" should be deleted from lines 3 and 4 of page 2. It should be noted that the language approved by the Senate Armed Services Committee in their DOD authorization provision on this subject treats subcontract equally with contracts.

The bill also focuses upon contracts with respect to which final payment is made before October 1, 1981 and, thereby, employs final payment as the necessary condition for a contract being exempted from Vinson-Trammell applicability. Our concern is with the final payment provision being used as a criterion for exemption. This could have unfortunate ramifications upon many contracts and subcontracts completed by October 1, 1981 but not paid for, by eliminating them from the exemption.

A comparison of the H.R. 7247 language with the recently passed FY81 DOD Authorization Act approved by the Senate Armed Services Committee depicts the parameters of our concern. Both H.R. 7247 and the Senate's provision call for a retroactive limit of applicability on the profit limitation requirements of Vinson-Trammell. However, they differ in their implementational approach to the matter. As stated H.R. 7247 employs final payment as the necessary condition for exemption. The Senate provision uses performance completed as its criterion for contract completion and, consequently applicability for exemption from Vinson-Trammell. EIA believes that a criterion based upon performance completion is more equitable in the present context and should, thereby, be the basis employed by H.R. 7247.

It is presumed that both H.R. 7247 and the Senate action are designed to give the Defense Department, the Internal Revenue Service, and defense contractors some relief from the unmanageable and costly requirements of Vinson-Trammell while allowing Congress time to consider the issue more closely. A final payment criterion like that purported in H.R. 7247 could frustrate this intended relief by subjecting certain contracts and subcontracts to Vinson-Trammell obligations. This would be the case with a contract that was performance completed prior to October 1, 1981 but in which final payment was not made until October 2, 1981. This scenario under H.R. 7247 would subject such a contract and its previously completed and paid subcontracts to the requirements of Vinson-Trammell. As I am sure you are well aware, final payment of a contract can be withheld for quite a long time pending final auditing procedures, etc. Therefore, based upon the presumption that Congress in attempting to facilitate relief for the various parties involved, EIA contents that, given the context of a retroactive limitation, an exemption applicability criterion of performance completion as opposed to final payment is warranted. Therefore, EIA supports the Senate's language in this instance and also believes its equal treatment of the terms contract and subcontract will provide for a more equitable and beneficial implementation process for all parties involved.

EIA further believes it beneficial for any legislative action at this time to delineate an intention to halt all agency regulating and reporting implementation requirements. A provision in line with section B of the Senate provision is necessary to accomplish this.

In conclusion, while EIA is generally supportive of the basic intent of H.R. 7247, we disagree with its provisions for the implementation of this intent and, therefore, recommend an implementation more closely aligned with the Senate provisions.

Thank you, I will be happy to answer any questions.

Mr. STRATTON. We will hear now from Mr. Hood.

Mr. HOOD. I am Edward M. Hood, president of the Shipbuilders Council of America, a national industry association composed of major shipbuilders, ship repairers and ship component manufacturers.

I am accompanied today by Mr. Charles T. Michaelian, manager of Government accounting requirements for Newport News Shipbuilding & Dry Dock Co., Newport News, Va.

I have a statement that supports the concepts of Mr. Price's bill. The proposed provisions have been fully aired here today. I request that my statement, as well as a supplementary explanation of our position on the philosophy of profit limitations, be made a part of the record of this timely hearing.

Mr. STRATTON. Without objection, the various statements will be included in the record.

STATEMENT BY EDWIN M. HOOD, PRESIDENT, SHIPBUILDERS COUNCIL OF AMERICA

Mr. HOOD. I have a few additional remarks that I think are necessary as a result of some of the colloquy that I listened to today. Like most others, we believe that the Vinson-Trammell Act is an outmoded vehicle for dealing with the problem of profit limitations.

We congratulate you, Mr. Chairman, and the members of the subcommittee, for taking an initiative in focusing attention on this problem. It is a very complex problem. It is really one that is important in protecting the public's very proper interest in preventing excessive profits on defense contracts.

As indicated in my statement, we do have a difference of opinion as to definitions or standards for a temporary waiver of the Vinson-Trammell provisions. I believe I can safely say that our members would accept any appropriate definition which would lead you and the Congress to establishing an effective, overall national policy for dealing with profits on defense procurements.

Having said that, Mr. Chairman, let me say that on behalf of the shipbuilding industry, I must take serious exception to the inferences expressed here today that U.S. shipbuilders have been the beneficiaries of excessive profits on naval shipbuilding contracts.

A recent Office of Naval Research study indicated that the shipbuilding industries' average earned profits, as a percentage of overall sales, amounted to one-sixth of 1 percent for the years 1967 through 1976. Shipbuilders could hardly be called profiteers, a word which has been bandied about this morning and even this afternoon.

I personally further differ with the statement that shipbuilders add 50 percent to their contract prices to cover the cost of paperwork resulting from Government regulations. Mr. McCloskey obviously has better figures than we do, but the Shipbuilders Council of America, which I am privileged to represent, has attempted to analyze this problem, and we conducted a very comprehensive study only last year.

Our best judgment, reflecting the expertise of experienced shipbuilders, is that the cost of building a commercial ship in an American shipyard has increased by approximately 15 percent as a result of the broad sweep of U.S. regulations which are imposed by the Congress and liberally interpreted by executive and independent agencies.

Obviously, by reason of the more precise requirements of naval shipbuilding, the percentage would be even greater. On behalf of our membership, I emphatically take exception to the inference that shipbuilders are going to get a free ride as a consequence of any temporary waiver of the Vinson-Trammell Act which the Congress, in its constitutional prerogatives and its political wisdom, decides as a proper policy for profit limitations.

The techniques used today by the Government in acquiring ships and aircraft have become so sophisticated as to foreclose the probability of profiteering in the construction of these essential defense commodities. The naval shipbuilding present-day techniques usually employ negotiation for a leadship on a cost-plus award-fee basis. All follow-on ships are on a fixed-price basis where target prices generally exceed the Vinson-Trammell limitations. This procedure is ongoing

in the present timeframe. Thus, there is an anomaly between present contract structuring and Vinson-Trammell profit limits.

I would suggest also that the subcommitee might want to carefully examine the implication that a shipbuilder was demanding a 38-percent increase on a design contract. Thirty-eight percent equated to what baseline would be the question this subcommittee, it would seem to me, would want answered.

From experience, I would judge that past profit returns on ship design work have been in the magnitude of 5 to 7 percent. In effect, the shipyard to which the admiral had alluded more than likely hopes for a profit on the order of 10 percent. It is hardly excessive in today's circumstances, considering especially the price of money.

Finally, Mr. Chairman, there have been repeated inferences today that defense contractors are a bunch of price gougers and obnoxious profiteers. I have great difficulty with such assertions which tend to brand the whole for the guilt of a few. For more than 2 years shipbuilders have been working diligently with the Navy Department, and still are, to perfect the procurement process and to minimize the ills of profiteering.

Progress has been made. Problems are being resolved equitably. And I would reiterate that shipbuilders are still not the beneficiaries of excessive profits. The records available to this distinguished subcommittee will show that profit levels across the board for shipbuilders are far less and have been far less than the 10-percent level, as promised by the Vinson-Trammell Act.

Thank you, Mr. Chairman.

WRITTEN STATEMENT OF EDWIN M. HOOD

Mr. Chairman, Members of the Subcommittee.

I am Edwin M. Hood, President of the Shipbuilders Council of America, a national industry association composed of major shipbuilders, shiprepairers and ship component manufacturers. I am accompanied today by Mr. Charles T. Michaelian, Manager of Government Accounting Requirements for Newport News Shipbuilding and Dry Dock Company, Newport News, Va.

We very much appreciate this opportunity to present our view on the proposed bill, H.R. 7247, which would waive the applicability of the profit-limiting provisions of the Vinson-Trammell Act until October 1, 1981. The matter of profit-limitation is one that has had considerable debate in recent times.

We have heard testimony this morning which advocates the unworkability of the present law, a position in which the shipbuilding industry heartily concurs. We have heard advocacy for substitute legislation, and in this matter, we also have a position. With your permission, Mr. Chairman, I would like to submit for the record our stand on the broader issue of profit-limiting requirements, while holding my remarks at this hearing to the more immediate need to set aside the requirements of the Vinson-Trammell Act.

We applaud your proposed action which recognizes that the Vinson-Trammell Act is an outmoded statute: it may have been needed in the 1930's but is now inappropriate. When that law was enacted, there was a single method used for naval ship acquisition, namely, formal advertising which resulted in a firm fixed price contract. Under such rules, it was possible that unwarranted profits could be realized when a contractor, to minimize business risks, included contingencies in the contract price.

However, the techniques used today by the government in acquiring ships, and aircraft, have become so sophisticated as to foreclose the probability of profiteering in the construction of these essential defense commodities. In naval shipbuilding, present-day techniques usually employ negotiation for a leadship on a cost-plus-award fee basis. All follow ships are negotiated on a fixed price incentive basis where target profits generally exceed the Vinson-Trammell limitations.

Thus, there is an anomaly between present contract structuring and Vinson-Trammell profit limits.

There is a widely accepted consensus that the profit-limiting provisions of the Vinson-Trammell Act should not be implemented. The most direct evidence of this statement would be the drawn-out debate between the agencies responsible for implementing these requirements. More than three and one-half years have past since this law was reinstated. In that time, the Internal Revenue Service and the Department of Defense have been unable to reach agreement on the rules.

There is equally wide-spread opinion as to the need for new or replacement legislation regarding profit limitations on defense contracts. While the shipbuilding industry holds the view that no additional legislative action is required other than repeal of the profit limiting portions of Vinson-Trammell, we recognize the realities of the situation and that further debate is inevitable. In this context, we support the concept of your bill H.R. 7247.

We do feel, however, that the more expedient approach to this matter would be to develop the solution proposed in the Senate version of fiscal year 1981 Department of Defense Authorization Bill, S. 2294. That bill, as proposed by the Senate Committee on Armed Services, contains a provision that also waives the applicability of the Vinson-Trammell requirements until October 1, 1981. We note that this provision is made applicable to contracts and subcontracts, subject to the Act, whose performance is completed in the specified time period. H.R. 7247, on the other hand, provides for contracts and subcontracts to which final payment is made. This difference reflects the past difficulty all parties have had in attempting to define the completion of a contract for purposes of profit reporting.

May we respectfully request that your Committee support in joint conference a provision in the Department of Defense Authorization Bill that, as in H.R. 7247, will waive the applicability of sections 2382 and 7300 to title 10, United States Code, to contracts for the construction or manufacture of naval vessels or military aircraft with respect to which "the subject of the contract, or any subcontract of such contract, has been delivered and accepted" before October 1, 1981.

We would further urge that additional language, similar to that in the Senate authorization bill, be included that would preclude the responsible agencies from requiring any reports or implementing any regulations under the current law prior to October 1, 1981.

This concludes my statement. We are prepared to answer any questions you may have. Thank you.

Mr. Chairman, Members of the Subcommittee.

The opportunity to express our views related to profit limitation legislation, and in particular those limitations contained in the Vinson-Trammell Act is very much appreciated. Although shipbuilders can hardly be countenanced as dealers in excess profits—a recent Office of Naval Research study indicated that the shipbuilding industry's averaged earned profits as a percentage of overall sales amounted to one-sixth of one percent for the years 1967 through 1976—we do have valid concerns that such legislation does not serve the national interest.

It is not our intent to say that there should be no regulation of profits. But we believe that the government's best interests are being served by limiting net profits through the means of income taxes and controlling gross profits through the existing contract and procurement process. We feel that no additional legislative action is appropriate at this time other than the repeal of the profit-limiting portions of the Vinson-Trammell Act. Our position is that the Vinson-Trammell Act is discriminatory and completely unnecessary in the light of: (a) more current legislation such as Public Law 87-653 dealing with contract negotiation and defective pricing; (b) the sophistication of present day Department of Defense acquisition techniques such as cost/price analysis and weighted profit guidelines; (c) the existence of a more sophisticated and highly-trained cadre of government contracting officers than might have been imagined back in the early 1930's when World War I profiteering was still a current issue.

Your Committee had been fully apprised of the trials and tribulations that beset the naval shipbuilding business in the 1970's, when cost overruns, claims and counterclaims seemed to be the order of the day. Much of those problems were rooted in the application of misdirected contracting policies which prompted

the Assistant Secretary of the Navy for Manpower, Reserve Affairs and Logistics to commission a detailed study of the naval ship procurement process. The conclusions of that study, which are also familiar to your Committee, have become the cornerstone of the improving performance you now see in our naval shipbuilding programs. This study also had this to say about the potential effect of the Vinson-Trammell Act on fixed price-incentive contracts, a contracting method now commonly used:

The net effect of the Vinson-Trammell Act on cost underruns is that the Navy is forced into a cost plus a percentage of cost arrangement below target cost, and the shipbuilder is given a negative incentive to underrun the target. Further, the Vinson-Trammell Act is inconsistent with the feature of Defense Procurement Circular 76-3 which provides for increased profits to contractors assuming risks through fixed-price-type contracts.

The conclusion of the Naval Ship Procurement Process Study was: "There is little need for such legislation in the current business environment where the Navy obtains its prices by means of competition or through vigorous negotiation."

We hold to that view and we are particularly concerned that substitute reform measures that have been advocated will add to the inequities of profit-limiting regulations rather than mitigate them. A case in point is the proposed bill HR-5433, the so-called Patterson Bill. Although intended to be narrow in application—aimed at sole source contracts—it contains a provision whereby any contract that has subsequent changes totaling more than $5 million shall be decreed a "noncompetitive" contract subject to profit limitation. The task of constructing a naval ship is an arduous one, taking from two to seven years to complete. In that time frame, it is inevitable that changes must be made to maintain the state of the art in weaponry and mission. I very much doubt that any naval ship built today could be performed under a contract whose changes cost less than $5 million. In effect then, the proposed bill defines all naval shipbuilding contracts as noncompetitive and subject to extraordinary profit review.

The Defense Department admits that such further legislation would only provide some "measure of assurance" that the existing contracting system is working as it is intended. Can we really afford the luxury of providing an extra ounce of protection? It must be remembered that whenever a bill becomes law and its administration becomes the responsibility of the executive branch, the Congress seldom hears of problems in implementation unless they grow to a significant magnitude such as happened with the naval shipbuilding claims I mentioned earlier. Often the administrative regulations issued to implement legislative measures go beyond the intent of Congress. We have a recent example where the Department of Defense issued its regulations on claim certification required by the Defense Appropriation Authorization Act for 1979. The regulation requires certification on all claims for equitable adjustment under a contract while the legislative history indicates that such certification should not apply to request for equitable adjustment agains changes issued by the government.

Any time a law is made, there are attendant costs and discretionary action which add measurably to the total cost of performing a contract. The need for such laws must, therefore, be clearly established. Congress spent two years examining the renegotiation process and determined it to be unnecessary, accepting that the Defense Department methods of procurement adequately minimize profiteering. The need for reneging or even fine tuning that position has not been demonstrated.

As I said at the outset, it would be a unique experience for a shipbuilder today to qualify for loss of earned profit under the current legislation. But there is a more urgent problem in dealing with the requirement to pass down profit restrictions and attendant audit burden to our suppliers. You have already heard testimony relating to the difficulties anticipated by subcontractors in accounting for their products that may ultimately find use in a naval ship, particularly those involved in production for both commercial and military purposes. Our concern in this case parallels that of the Defense Department. The Deputy Under Secretary of Defense for Acquisition Policy, Mr. Dale W. Church, testifying before the Senate Armed Services Committee on March 5, 1980, regarding this Nation's industrial readiness, stated, "We must look to profit and business stability as the primary incentives for a viable base. Unfortunately, defense programs do not always offer these incentives. The steady growth of the commercial market when compared with the cyclical nature of defense business * * * has made

defense business unattractive to many suppliers. Additionally, the myriad of government policies and the restrictions of government practices, act as disincentives to many potential suppliers." He stated further that, "The current condition of the U.S. industrial base can be characterized as unbalanced * * * deficiencies exist at the subcontractor and vendor levels today. The deficiencies exist particularly due to some choosing not to participate because of government red tape." Those are real life facts, and we are concerned.

In closing, from previous testimony before this Subcommittee there unquestionably appears to be a consensus that the profit-limiting provisions of the Vinson-Trammell Act must be eliminated. Since these provisions have been in effect since October 1, 1976, and the government agencies involved have yet to devise a practical procedure to implement them, it is imperative that Congress act now to terminate this unwarranted and burdensome requirement. Recognizing the limitations of time and other pressing business before this Congress but because of the urgency of this matter, we do endorse the concept of H.R. 7247 which waives the applicability of the profit limitations contained in the Vinson-Trammell Act until October 1, 1981. It is sincerely hoped that in the ensuing period, Congress would find in its wisdom that the need for new profit-limiting legislation has not been demonstrated and that the current policies and practices of defense contracting adequately serves the public's interest.

Thank you, Mr. Chairman.

Mr. STRATTON. Thank you, Mr. Hood.

Our next witness is Charles Stewart, president of the Machinery and Allied Products Institute.

Mr. Stewart?

Mr. STEWART. Thank you, Mr. Chairman.

I am accompanied by the senior staff counsel, William Healey.

I would like permission of the committee to have our full statement entered into the record, and I will depart from it so as not to consume unnecessary time and also to be responsive to some of the points raised today.

Mr. STRATTON. Without objection, it may be put into the record.

STATEMENT OF CHARLES W. STEWART, PRESIDENT, MACHINERY AND ALLIED PRODUCTS INSTITUTE

Mr. STEWART. First, let me make clear in brief what our basic position is. Our central position is that the Vinson-Trammell Act should be repealed forthwith. It is unadministrable, obsolete and is contrary to good Government policy.

We are realistic, however, with regard to the timetable of this Congress; and in the absence of time to address that question, on which we have established a position, we support the approach of a suspension or waiver of the Vinson-Trammell Act.

When you get to the details, perhaps I can summarize a bit. I hope to be helpful in terms of any work that the committee and its staff does in the implementation of the concept of a waiver or suspension.

First of all, the chairman has asked the question several times today—and I do not think until late in the day got the proper answer—with respect to the reinstatement of Vinson-Trammell: Does it require, at the expiration of the 5-year period, an overt or affirmative act on the part of Congress?

I think the answer under the proposed statutory language, is clearly, no. At the end of the period, the Vinson-Trammell Act, if not modified or acted upon by the Congress in the interim, will go automatically back into effect. Now, whether that is a good thing or not is beside the point. I think that is a fair answer to your question.

Second, I would like to suggest that you have a central problem that has been underlined with respect to the cutoff provision of the 5-year suspension period. You have at least three, if not four or five, alternative approaches to designing a cutoff.

The final price is the approach of Congressman Price's bill; and, second, completion of performance, which is the Senate version; and the DOD has suggested a third, namely the part of any contract or subcontract that is performed utilizing fiscal year 1981 or prior year appropriations would be exempt from the Vinson-Trammell Act.

There is a fourth that we would like to advance, namely, any contract or subcontract entered into during the 5-year period would be subject to the waiver.

In general, I think it is fair to say that you cannot leave in place the present provision of cutoff that is in the bill as now drafted. There is absolutely no equity in ruling that a contractor who has completed a contract but not received a final payment is not entitled to the exemption or the waiver, while the contractor who has received a final price is.

The GAO prefers the Price version on the grounds of administrative feasibility. That is hardly a good rationale for writing a statute, when there is no equity in the pertinent provisions, as I have just pointed out.

You run into the problem mentioned by DOD. It is' that based on their examination of aircraft and ship contracts, there would be no effective exemption or waiver that would be brought about by the present cutoff provisions in the bill. That is your first problem, assuming that you proceed with the waiver approach; that is to design an effective, a fair, and a correct cutoff provision.

The second problem that has been referred to is the subcontract problem. Now there the Price bill is faulty. It would make the waiver applicable only to subcontracts under subject prime contracts. This point has been made by several witnesses. The Senate version on subcontracts is preferable in that it would apply to subcontracts that would otherwise be subject to the act, regardless of whether they fall under a subject prime contract.

The third point is whether you borrow the prohibition against issuing regulations or mandating requirements as contained in the Senate bill. One witness said he did not think it was necessary. I would prefer to see it in the House bill.

It seems to me those are the three areas the committee has to address in finalizing waiver legislation; if it is its judgment to proceed in that direction.

I think a further point should be made, that I think would be helpful to the committee, as to whether there is time and sufficient knowledge for the Congress to adopt something like the Patterson bill as an amendment to the Vinson-Trammell Act, and to proceed with it in lieu of a waiver. I strongly recommend that there is not time. There have been no hearings held on the Patterson bill. There are problems with regard to the Patterson bill that are easily surfaced, as contrasted to Mr. Patterson's testimony that it is not very complicated.

Let me cite one. Congressman Daniel asked a very legitimate question: What is an excessive profit? It is a very hard question to answer.

Everyone has a different answer. Under the renegotiation law, excessive profit was determined by reference to some vague criteria. Actually, the Board picked off the ceiling when it came down with it. answer. There is a reverse side to that coin; namely, what is an inadequate profit? It is just as difficult to define. Anyone what wants to responsively deal with a question of excessive profits has to deal with the inadequate profit side.

One concern is that the Patterson bill, in reference to the point I am now making, is a contract-by-contract apparatus. Each contract would be looked at when it is subject to the bill as contrasted with the approach of an overall examination of all contracts in a year. Suppose a contractor is caught in the net of the Patterson bill on one contract and loses money on four of them. The bill would reach that individual.

It is said of the Patterson bill that only a very few contractors would be affected, only a very few. I am not satisfied on that point. I would want to deal with it very carefully.

In a nutshell, my point is simply this. This Congress does not have the time to deal with the complexities of the Patterson bill or any other substitute for Vinson-Trammell, and if it does not wish to bite the bullet and repeal an obsolete law, then it should pass legislation modeled after these waiver proposals.

I have one final comment. I join Mr. Hood in his reaction to some of the emotional comments that were made with respect to the conduct of procurement by Government contractors. My organization is not primarily a Government contractor entity, but we have had considerable experience in the field.

When you are challenged, as the committee was today, by such statements as "war profiteering," et cetera, then I want to call your attention to a few things that go on in this mysterious process called Government procurement. First of all, there are a large number of companies, many of them that are members of MAPI, that got out of the Government contract business because they do not want any part of it. They do not like it, that is, except in time of war or other emergencies.

You have seen the handling—and this chairman is very familiar with it—of the famous ship claims. Anyone who would deny that there were two sides to that argument really does not know the facts.

There are contractors today who, in response to our new sense of national security—and I trust that will be expanded—have been operating on letter or telephone contracts without any definitive agreement whatsoever. How can such a company be called a profit gouger?

Procurement authorities are famous for passing on numerous, burdensome, and sometimes unnecessary technical changes. It is almost impossible to live with.

Contractors are frequently confronted with a situation where they have no assurance of a follow-on contract, yet they may be asked even to make expensive facility investments.

The Government on occasion is guilty of improper utilization of proprietary data

The Government is guilty of abusing the Freedom of Information Act at times.

There is a tremendous burden placed on Government contractors with regard to executing complex certifications with respect to cost

data that the Government will look at retrospectively and perhaps question it.

Some suggestion was made as to why the contractors would object to arbitrary time limits on claims being filed. It is simply for a number of reasons, including change orders. A premature cutoff on claims, as the admiral suggested, would not be in the interest of the stockholders of that corporation; it would be inequitable.

Also it was suggested that companies do not like to definitize their contracts. That is bunk. Most companies are anxious to have a definitive agreement at the earliest possible date within reason. We were asked by one major contractor to make that point in this hearing.

I do not want to close on this rebuttal note. I have attempted to outline our basic position and call the subcommittee's attention to those aspects of the waiver approach which I think, and others have testified to, need further study and development of language.

If we can be of assistance in that process in any way, please call on us. Thank you.

Mr. STRATTON. Thank you very much, Mr. Stewart. Your statement has been very helpful. You have pinpointed a number of key problems.

Mr. STEWART. Thank you.

WRITTEN STATEMENT OF CHARLES W. STEWART

We appreciate the opportunity to present the views of the Machinery and Allied Products Institute on H.R. 7247, a bill introduced by Chairman Price to waive the application of Sections 2382 and 7300 of Title 10 of the United States Code (the profit limitation provisions of the Vinson-Trammell Act) to contracts and subcontracts thereunder for the construction or manufacture of naval vessels or military aircraft with respect to which final payment is made before October 1, 1961.

The Institute represents the capital goods and allied products manufacturers of the United States. Although by far the major part of the sales of these companies is in the commercial market, many of them produce highly engineered items and equipment which are indispensable to the defense effort and, ultimately, to our national security. Much of this defense work relates to naval vessels and military aircraft, particularly at the subcontract level, and is subject to the Vinson-Trammell Act. Hence our deep concern with the difficulties resulting from possible application of the Act.

As you know, the current Vinson-Trammell problem arose when Congress declined to extend the application of the Renegotiation Act beyond September 30, 1976. This meant that the Renegotiation Act did not apply to the performance of defense contracts and subcontracts after that date. But the Vinson-Trammell Act had been suspended during the operation of the Renegotiation Act, and the failure to renew the Renegotiation Act meant that the Vinson-Trammell Act automatically became at least technically operative with respect to contract performance after September 30, 1976. The Vinson-Trammell Act, which dates back to 1934, imposes flat-rate profit limitations on contracts and subcontracts for naval vessels of 10 percent and for military aircraft of 12 percent.

Our position on H.R. 7247 is, in essence, quite simple. We strongly oppose any attempt by the government to enforce the rigid, obsolete, and unadministrable Vinson-Trammell profit limitations. Indeed, speaking generally there is a unique consensus in government and the private sector that the Vinson-Trammell Act should be repealed.[1]

Accordingly, we support outright repeal of the Act. If repeal cannot be promptly legislated, however, we endorse as an interim action the basic concept of the pending bill—that is, the waiver of the application of the Vinson-Trammell Act for the five-year period September 30, 1976 through September 30, 1981—which would effectively preclude any attempt by the government to enforce the Vinson-Trammell Act at the present time. Although we support this basic concept, we

[1] It should be acknowledged that this remarkable consensus does not extend to the question of whether a substitute profit-limitation measure should be adopted.

have reservations with respect to two features of the bill—(1) the "cut off" provision under which Vinson-Trammell requirements would be waived only with respect to contracts for which final payment is made prior to October 1, 1981, and (2) the manner of the application of the waiver to subcontracts.

The enactment of a five-year waiver of Vinson-Trammell application, which would postpone consideration of the Vinson-Trammell Act on the merits until next year and stop enforcement activity until that time, is imperative at this point. Currently, the filing date for initial contractor Vinson-Trammell reporting to the Internal Revenue Service is set for next October 15, following a series of five earlier extensions of the due date. Moreover, Treasury officials have indicated their reluctance to provide any further extension beyond next October 15, thus increasing the need for congressional action. Further, both from the government and private standpoint, Vinson-Trammell represents a serious cloud over the defense procurement process.

The discussion which follows deals with these central points:

1. If the Vinson-Trammell Act is now allowed to go into operation, it will cause major insurmountable problems and difficulties; therefore, it is necessary to enact legislation to ensure that that does not happen.

2. Such legislation should provide a five-year waiver of Vinson-Trammell liability but with the waiver to cover contracts *awarded* before October 1, 1981, and any *subject* subcontracts and not merely those under *subject* prime contracts.

THE NEED FOR MAKING THE VINSON-TRAMMELL ACT INAPPLICABLE

At the outset, we think the following structural deficiencies in the Vinson-Trammell Act indicate that it should never be allowed to go into operation.

1. By singling out contracts and subcontracts relating to naval ships and military aircraft for profit limitation while ignoring other defense items and equipment, the Act discriminates against ships and aircraft without any apparently rational reason for doing so.

2. By simply requiring refunds to the government of profits above the prescribed maximum of 10 percent and 12 percent, the Act disregards contractor efficiency and other relevant considerations.

3. The threshold for the Act's application—all prime contracts and subcontracts exceeding $10,000—is ridiculously low; it was established in 1934 and does not reflect the differences in price levels between then and now, some 46 years later.

4. The Act extends to all subcontracts which can be identified as such regardless of tier and remoteness from the prime contract, so long as they exceed $10,000 in amount.

5. The Act exempts only scientific equipment for communications, target detection, navigation, or fire control. Thus it subjects to full liability competitive contracts and those for standard commercial items or as to which the price was based upon adequate price competition or established catalog or market prices of commercial items sold in substantial quantities to the general public (categories which are normally exempted under comparable legislation such as the Truth-in-Negotiations Act).

For its part, the Defense Department obviously agrees with these views. Indeed, in a letter dated December 21, 1977 to Senator Ribicoff, Chairman of the Senate Committee on Government Affairs, commenting on S. 1264, a bill introduced by Senator Chiles to reform federal procurement statutes and policy, DOD recommended repeal of the Vinson-Trammell Act on the grounds that it is obsolete, discriminatory, and unnecessary.

Clearly, the Vinson-Trammell Act is poor public policy and it would be unwise to permit it to go into operation. Of perhaps even greater importance, the Act's operation, again according to the Defense Department, would create major problems apart from these public policy objections. In a 1978 letter to the Commissioner of Internal Revenue, Defense Under Secretary (Research and Engineering) Perry placed particular stress on the paperwork burden and costs of compliance with the Vinson-Trammell Act—"over 1 million individual contract reports [it has been estimated] will [have to] be filed annually pursuant to the Vinson-Trammell Act by more than 30,000 contractors."

Moreover, in testimony on February 25 before the Senate Armed Services Subcommittee on Procurement Policy and Reprogramming, chaired by Senator Morgan, Dale Church, Deputy Under Secretary of Defense for Acquisition

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Policy, stated the reasons against application of the Vinson-Trammell Act in very persuasive terms. The pertinent part of Mr. Church's comments is as follows:

There are a number of serious problems associated with implementation of the Vinson-Trammell Act. While most of these are administrative, we believe implementing the Act would have a devastating impact on the industrial base. While no precise figures are available, we understand that surveys conducted by industry associations indicate that as many as 40 percent of the smaller subcontractors who have business covered by the Act would simply stop accepting orders subject to record keeping and profit limitation required by the Act. Another 20 percent would look at each order on a case-by-case basis and only accept orders for items with profit margins that are less than the limits imposed by the Act. Many of these firms are in high technology areas and supply items that are critical for our aircraft and ship systems.

The most significant administrative problem is determining which items in contracts and subcontracts are covered by the Act. While this is not too difficult at the prime contract level, it is a most vexing problem with first and lower tier subcontracts. These subcontracts may include quantities of material or supplies destined for both end items covered by the Act and for material inventories or stocks of spare parts, which would not be covered by the Act. This would result in only a portion of the subcontract being subject to the profit limitation, and create an enormous and costly record keeping and accounting problem for these suppliers.

In fairness, we should acknowledge that DOD has changed its mind concerning what ought to be done when the Vinson-Trammell Act is terminated. Originally, as indicated above, it advocated Vinson-Trammell repeal. However, in his testimony before the Morgan subcommittee, Secretary Church went on to strongly recommend that the Vinson-Trammell Act be replaced by an alternative form of profit limitation, the "desirable characteristics" of which he spelled out. In essence, it appears that this was intended to describe an approach such as that contained in H.R. 5433, introduced by Congressman Patterson of California, which would substitute for the Vinson-Trammell Act a recapture by the government of profits in excess of 15 percent of the contract price on so-called "noncompetitive" negotiated defense prime contracts and first-tier subcontracts exceeding $5 million in amount. On the other hand, several distinguished members of Congress—including Senator Cranston of California, Senator Lugar of Indiana, Senator Mathias of Maryland, and Congressman McCloskey of California—as well as MAPI and most other nongovernment parties have strongly recommended to the Morgan subcommittee repeal of the Vinson-Trammell Act without substitution of any alternative form of profit limitation such as that embodied in the Patterson bill.

Nevertheless, we recognize that this hearing is not the occasion to address the issue of repeal versus revision of the Vinson-Trammell Act. Moreover, despite our differences with the Defense Department as to what we think ultimately ought to be done concerning Vinson-Trammell, we agree completely with its assessment of the problems which the Act's implementation and enforcement at the present time or at some future date would create.

THE PROPOSED FIVE-YEAR WAIVER OF VINSON-TRAMMELL APPLICATION

Since nearly everyone who has examined the current situation agrees that the Vinson-Trammell Act ought not to be allowed to go into operation, the question arises as to what ought to be done concerning this situation at the present time. As we have indicated, we strongly advocate repeal of the Vinson-Trammell Act. But we agree with the reasoning implicit in H.R. 7247 that there is insufficient time remaining in the current second session of the 96th Congress to expect that the future of the Vinson-Trammell Act can be finally disposed of this year. Accordingly, we support the proposal to waive Vinson-Trammell application in the interim. This reasoning apparently has persuaded the Senate Armed Services Committee to add to S. 2294, its version of the fiscal year 1981 Defense Authorization bill, an amendment proposed by Senator Morgan which embodies a version of the five-year waiver somewhat different from that provided in H.R. 7247. At this point, we discuss these two versions of the five-year waiver, and finally the version which we think is preferable.

H.R. 7247—the "final payment" standard and subcontracts.—As you know, H.R. 7247 would provide that the profit limitation provisions of the Vinson-Trammell Act—

. . . shall not apply with respect to any contract for the construction or manufacture of all or any part of any aircraft or naval vessel with respect to which final payment is made before October 1, 1981, or to any subcontract of such a contract.

In our view, there are two problems with respect to this legislative language:

1. The cut-off date for the waiver is phrased in terms of when final payment is made under the contract rather than when it is completed. This, it seems to us, will unduly extend what amounts to the term of the contract beyond that ordinarily contemplated. To be more specific, final payment under the contract may, at least in certain cases, be made considerably beyond the time in which the contract is usually regarded as completed in terms of final delivery. Thus, the "final payment" standard will tend to except from the five-year waiver some long-term contracts which would otherwise be regarded as completed. We think that such a reduction in the scope of the waiver is not desirable; it would discriminate among contractors who are similarly situated except for the fact that, for some, final payment has not been made prior to the October 1, 1981 deadline.

We realize that in a different context—the development of the Vinson-Trammell implementing regulations by the Internal Revenue Service—it has been argued by some that the term "contract completion" for Vinson-Trammell Act purposes should be defined as when the contract price has been agreed upon or when there has been delivery of the contract items, whichever is later. In that case, the issue arises in determining whether a contract is completed in a particular year for purposes of imposing Vinson-Trammell liability with respect to that contract and for that year. This is, of course, an entirely different matter from that now being considered—the proposed five-year waiver of Vinson-Trammell liability for the purpose of avoiding undue burdens and hardship otherwise resulting from its application at the present time. We think that there is no sound reason why the term "completed contract" must be defined in the same way in these two obviously different contexts.

2. The subcontract problem under the pending bill arises because of the fact that the subcontract waiver is applicable only to subcontracts under "waived" prime contracts rather than *any* subcontracts which are otherwise subject to Vinson-Trammell. This means that the waiver extended to subcontracts would be considerably more limited than that applicable to prime contracts. To illustrate the point, liability with respect to a prime contract would be waived providing final payment is made before October 1, 1981. On the other hand, a subcontract would appear to be excluded from the waiver even though final payment under that subcontract had been made before October 1, 1981, providing final payment under the prime contract is not made until after the deadline date. This is a completely incongruous result—the nonwaiver of the subcontract under the same circumstances as would mean waiver for the prime contract—and we think that it clearly ought to be changed.

The Senate provision—completion of contract performance.—The Vinson-Trammell waiver provision in S. 2294, the Senate Armed Services Committee version of the FY 1981 Defense Authorization bill, applies, as we understand it, to any contract or subcontract for which performance was completed during the period October 1, 1976 to October 1, 1981.

The bill also provides that contractor filings under the Vinson-Trammell Act shall not be required before the October 1, 1981 deadline nor shall any implementing regulations (and such regulations were proposed by the IRS on October 26, 1979) be promulgated to be effective before that date.

As between the two bills, we think that the Senate provision is clearly preferable. It avoids what we think is the undesirable limitation on the waiver contained in H.R. 7247, by using a standard of completion-of-contract performance rather than when final payment is made under the contract. Moreover, it seems to us that the term completion-of-contract performance as a standard is desirable from another point of view. It tends to avoid the potential problems implicit in the use of the simple term "contract completion" noted above: the possible argument that it might be inconsistent to define that term one way in Vinson-Trammell regulations and in an entirely different way in a statute providing a five-year waiver of Vinson-Trammell liability.

In addition, the subcontract problem in H.R. 7247 is avoided by phrasing the waiver of subcontractor liability in terms of "any . . . subcontract" rather than

"any subcontract of such a [prime] contract [or higher tier subcontract]." This means that prime contracts and subcontracts would be treated in the same manner with respect to waiver qualification.

The ideal solution—basing the cut-off date on contract awards.—As we have said, the Senate provision is clearly preferable to the language in H.R. 7247 and, if the choice before Congress now were to be considered limited to these two options, we would urge, of course, that H.R. 7247 be amended to delete its present text in favor of the Senate version. But we see no logical reason why the choice should be so limited. What we recommend is that the Senate version be used with one exception—the term "awarded" should be used in place of the term "for which performance was completed." And it should be specified that the date of contract award is the date of a letter contract or comparable preliminaries when such occur and not the date on which subsequent contract definitization takes place. The balance of the Senate language should be retained, including particularly the mandates to the IRS and DOD to not require contractor filings under Vinson-Trammell prior to October 1, 1981, and to not promulgate any Vinson-Trammell regulations to take effect before that date.

Under this approach, the waiver of Vinson-Trammell would apply "to any contract or subcontract awarded during the period October 1, 1976 to October 1, 1981." Obviously, such a modification would extend the Vinson-Trammell waiver to cover contracts which would otherwise be subject to the Act because they are completed after the October 1, 1981 deadline. We think that such an extension of the waiver is logical because of the basic justification for providing a Vinson-Trammell waiver at this point; i.e., it clearly makes no sense whatever to apply the Vinson-Trammell Act to any contracts—either now or in the future—in view of the general concurrence among all parties concerned that the Act's requirements both constitute bad public policy and are substantially unworkable. Even if some form of profit limitation such as that embodied in the Patterson bill is eventually enacted into law (a course of action as to which we have indicated our strong opposition), it would not be fair or reasonable to apply any such requirements retroactively to contracts awarded prior to the effective date of any such new profit limitations. Any such requirements presumably should be included as pertinent provisions in the subject contracts and subcontracts at the time they are awarded. Further, it is not realistic to assume that any new statute would be enacted much prior to October 1, 1981—indeed, that presumably was the reason for selecting that date.

Accordingly, it seems to us that there is no real reason not to extend the waiver of Vinson-Trammell liability to any contract or subcontract awarded prior to the October 1, 1981 deadline, and we so recommend.

This concludes the MAPI testimony. We will be pleased to be of assistance to the subcommittee and its staff if MAPI is called upon.

Mr. STRATTON. We are faced with another vote. We still have Mr. Hahn's statement, and then we may have some questions to toss out to you individually or as a group to follow up your statements.

The hour, I know, is getting late. We will take another 10-minute break, and will return and conclude the hearings.

Thank you, very much.

[Whereupon, a short recess was taken.]

Mr. STRATTON. The subcommittee will come to order.

We have one more statement from Mr. Hahn of the Alliance of Metalworking Industries.

Mr. Hahn, I take it you do not plan to read your entire statement.

STATEMENT OF BRUCE N. HAHN, ALLIANCE OF METALWORKING INDUSTRIES

Mr. HAHN. Now that you mention it, I was lobbied heavily by my fellow panelists to be succinct and brief.

I would like to submit my testimony before the committee and the attachments, which is a record of the testimony before other committees.

Mr. STRATTON. Without objection, it will be included in the record.

Mr. HAHN. I will try to be brief.

We are very, very happy to be here today. We are very, very happy with the interest shown by many, many people who have addressed this committee, as well as the members of the committee, for the effect on the smaller companies, the subcontractors.

I am here representing the smaller companies that are subcontractors by and large.

I am Bruce Hahn. With me is Ms. Ilona Hogan, the attorney for the Alliance of Metalworking Industries. I am representing the National Tooling & Machining Association as well as five other predominantly small business industries who make up the Alliance of Metalworking Industries. We also represent the Forging Industry Association, the Metal Treating Institute, the National Screw Machine Products Association, the American Metal Stamping Association, and the Spring Manufacturers Institute.

We are 100 percent small business. We have shops everywhere from Danville to Albany. They are doing everything from making parts for textile machines in the South to a lot of DOD subcontracting in the Northern sector.

Several people have alluded to the burden of reporting to the smaller companies under the Vinson-Trammell Act. That is perhaps a little inaccurate. By and large, the small companies cannot report.

We did a survey of our members. Of those who do DOD subcontracting work, 98 percent of the companies would not be able to comply with the act. Most of them do not have sophisticated accounting systems. They are small businesses, and they have simple accounting systems. These systems tell them whether they make a profit, whether they are making or losing money and when.

Between the recordkeeping aspect of retaining records back to 1976, and the accounting systems that they have, it's just not feasible for them to comply. I have talked to some company presidents about that. The accounting and reporting requirements, well, they do not even know what the cost accounting standards in Vinson-Trammell require.

I have called a couple of their accountants, and they are not familiar with these complex standards. You have got a real problem.

A couple of other problems: from the standpoint of small business, there is a state of uncertainty. Under the present provisions of Mr. Price's bill, and even to a lesser degree in the Senate amendment, the company does not know whether it would have to report. It depends on whether the contract is completed or paid, whichever language you want to use, by October 1, 1981.

They have an unkown contingent liability. If they should happen to fall into that, a small company cannot afford to carry contingent liabilities which are unknown at this time because they do not know whether they would fall under the act or not.

Another problem that Mr. Stewart mentioned is that of traceability. A small company produces many critical parts. They may go into, in the case of an engine part, into an engine part of a commercial aircraft or a military aircraft or it may be a spare part. They cannot tell whether or not they are going to have to report.

There is also the profit limitation. Under Vinson-Trammell that is 10 or 12 percent. You cannot deduct interest expense; these days the interest expense is a very high cost of doing business, especially for a small company. In 1934 when the Vinson-Trammell Act was passed, 10 or 12 percent may have been a reasonable amount of profit. This was pretax profit.

Corporate taxes were very low, and it did not reduce it by much.

There are other problems that affect both the small companies and the large companies. In various hearings that I have attended, I have heard estimates of up to 500,000 reports per year, which would mean something on the order of 2 million reports back to 1976. If those reports cost perhaps $200 each to complete—and I have heard figures to that effect—then you are talking about $400 million to complete the reports, an average of $100 million per year.

In addition, IRS has estimated that they would require 1,500 agents to administer this. If you figure the cost of sustaining an agent is $50,000, including secretarial assistance and heat, light and rent, then you are talking an additional $75 million a year.

In light of what has been recovered, $175 million a year is not cost effective, I do not think.

Let me give you also these definitional problems. What is a complete aircraft? Does it include missiles, ammunition, lubricants, gasoline, whatever?

Let me make several suggestions, if I may. I would like to endorse Mr. Stewart's suggestion that for purposes of certainty that the language be changed to cover contracts or subcontracts entered into prior to October 1, 1981. In the present language of Mr. Price's bill there are several places where it does not say "and subcontractors." On page 4, line 1, we would suggest that you insert the words "or subcontract." We would also suggest somewhere that you consider language to the effect that "IRS and DOD shall not require any report until October 1981, nor shall regulations implementing such section be promulgated to be effective before October 1, 1981."

We believe the intent of the legislation, both in the Senate amendment and Mr. Price's, is to delay the reporting to give the next session of Congress a chance to work out something which may address the problem in a little better fashion.

We have looked closely at all of the legislation that has been offered. We think Mr. Patterson's approach, raising the reporting level, has some merit. The merit obviously is you thereby remove the small companies who cannot possibly comply, and the people who would be forced to comply are at least those which have the means with which to do so, that have the sophisticated accounting systems.

We must also echo the points made by my fellow panelists. The act is archaic. There is not a cost justification or moral justification for it. At some time, I think, in the next Congress, once the two versions have been resolved, I think that repeal should be given serious consideration.

Thank you.

WRITTEN STATEMENT OF BRUCE N. HAHN

Mr. Chairman and members of the Committee, my name is Bruce N. Hahn, manager of government affairs for the National Tooling & Machining Associa-

tion. I am testifying today on behalf of our industry and the five other associations that make up the Alliance of Metalworking Industries.

The Alliance of Metalworking Industries represents a significant and critical segment of our national manufacturing industry. It consists of six member associations: Forging Industry Association, the Metal Treating Institute, the National Screw Machine Products Association, the National Tooling & Machining Association, the American Metal Stamping Association, and the Spring Manufacturers Institute. These six associations in turn represent 4,883 separate companies, 98 percent of which are small businesses. These companies employ 880,250 employees and produce combined annual sales of $34.8 billion. Members of the six associations have an average of 46 employees per plant, producing average sales of $1.82 million per company. Most of our members are small businessmen, often in a lower tier of the manufacturing process but they are essential to the defense industry.

Titanium forgings are used for aircraft landing gear struts, critical engine parts are machined or stamped, and nose cones for aircrafts are spun. These are just a few of the examples of products produced by our member associations. Prime contractors do not have the expertise nor is it economically feasible for them to buy the expensive and highly specialized machinery required to do this work. In many cases, there may be only one or at most a handful of subcontractors in the entire country with a particular highly sophisticated and very expensive machine tool required to produce a specific part for a Department of Defense contract.

We strongly urge this Subcommittee to act favorably on H.R. 7247 introduced by Congressman Melvin Price. If action is not taken to defer the implementation of the Vinson-Trammell Act, it is quite probable that subcontractors in private industry will be unable to produce critical parts for certain shifts in aircrafts and ships which the Department of Defense expects to purchase.

A survey of the membership of the National Tooling & Machining Association revealed that 98 percent of the companies would be literally unable to comply with the Vinson-Trammell Act due to lack of sophisticated accounting systems as well as a lack of historical data going back to October 1, 1976.

Our typical member has a basic accounting system which provides him the necessary data to determine whether he is making or losing money, and where. This type of accounting system bears no resemblance to the sophisticated system which would be required in order to comply with the Vinson-Trammell Act. It is our belief that many of these small businesses which now compete in very specialized segments of the defense subcontract market would be forced to abandon work subject to the Vinson-Trammell Act due to the economic burden of compliance costs. In some cases, a company might be the sole supplier of a specific type of highly specialized metalworking product. In others, it is conceivable that all two or three or four companies capable of doing the specific specialized work might withdraw from DoD competition.

From this, it is obvious that at some point in time, the Vinson-Trammell Act must either be repealed or receive major modification. For example, raising the minimum contract reporting level from $10,000 to $1 million or even $5 million would remove the small less sophisticated companies who would be unable to comply with the reporting requirements.

We have several minor suggestions for improvement of H.R. 7247 to clarify and improve the Bill.

First, we suggest that it be amended so that it includes subcontractors who receive final payment prior to October 1, 1981. Under the present language, it is unclear whether or not a subcontractor who finishes his work and is paid before October 1981 would have to report in a situation where the prime contractor had not yet received his final payment.

Therefore, a subcontractor may have completed his work and been paid for work on one part of a product but would still be required to report under the Vinson-Trammell Act if the prime contractor or another subcontractor had not finished work or been paid on an entirely different part. The words "or subcontract" should be added to line 4 page 1 and line 1, page 2.

Secondly, the language of the Bill will be interpreted to mean that a contractor or subcontractor must still report presently if final payment is not expected before October 1, 1981. As we mentioned before, 98 percent of our companies do not have the sophisticated accounting systems required to comply with the Vinson-Trammell Act. We believe the intent of this Bill is to suspend reporting under the onerous terms of the Vinson-Trammell Act in order to

provide an opportunity to more thoroughly review the Act and its implications in the coming Congress. In view of this, H.R. 7247 should be amended by changing "final payment" on page 2 to "completion of the contract or subcontract" so as to make it clear that the Vinson-Trammell Act is suspended until that date, especially for the small subcontractors. Additionally, we recommend that the H.R. 7247 include the following language to remove all doubt about congressional intent: "The IRS and DoD shall not require any report until October 1981 nor shall regulations implementing such section be promulgated to be effective before October 1, 1981. We believe that the Vinson-Trammell Act should ultimately be repealed for several reasons. First, in 1976 when Congress decided not to extend the reporting requirements of the Renegotiation Act of 1951, it did so knowing that the lapse of the Renegotiation Act reporting requirements would trigger the onerous reporting requirements of the Vinson-Trammell Act.

In the three year period since that date, the Treasury and DoD, two of the senior agencies of the Executive Branch charged with developing and issuing regulations to implement the Act, did not provide any guidance for our member companies to enable them to comply with the Act. IRS, acting on behalf of Treasury, issued proposed regulations for the first time in October 1979. In the interim, however, our members had no way of knowing what data they might be required to generate in order to comply with the Act. It is obviously unfair to expect them to produce data that does not exist.

Secondly, under the Vinson-Trammell Act, our members will be required to set-aside reserves in 1980 for potential, yet undefined. Vinson-Trammell liability for more than three years of booked profits. This liability cannot specifically be determined under the Act or the regulation and will place an unfair burden on our members at a time when they are already troubled by the highest inflation interest rates in recent history.

The $10,000 minimum contract reporting level may have been appropriate in 1934. At that time, $10,000 was worth a lot more and inflation and the increase in sophistication of military hardware has since caused a number of subcontracts and associated paperwork involved to be more than 50 times the original number contemplated by Congress. We anticipate that the companies who are members of our associations would have to file an estimated 500,000 reports for individual contracts each year at an estimated cost of at least $200–$250 per report. The present backlog of reports due on October 1980 could be an excess of 2 million.

An additional problem inherent in the Vinson-Trammell Act that may be remedied only by congressional action is the profit limitation. Ten percent and twelve percent pre-tax profits with no provision for deduction of interest expense may have been fair in 1934. At that time a much higher proportion of business was done on a cash basis and corporate income taxes were far, far lower. With a 46% corporate tax rate and the high carrying charge for interest in today's market, a company could scarcely make any net profits under this arrangement. By restricting net profits, we would restrict the ability of private industry to reinvest and therefore to supply future defense needs.

A special problem for the small business subcontractor is traceability. It is very often impossible to identify and trace parts which may be subject to the Act. For instance, many of our members produce thousands of small parts for aircraft engines. Even when it is known that a part will go into an engine, it is not known whether that engine will become part of a military aircraft, a commercial aircraft, or a spare part for either. And it is impossible to make the required determination of the destination of the part in order to make the reports required by the Act in proposed regulations. The Alliance of Metalworking Industries has testified extensively on the problems of the Vinson-Trammell Act. I have attached to our testimony copies of testimony that we gave before the Department of Defense, the Internal Revenue Service, and a statement which was submitted to the Senate Armed Services Committee on April 24. I request that these attached documents be made a part of the record.

Thank you.

STATEMENT OF THE ALLIANCE OF METALWORKING INDUSTRIES

Mr. Chairman and members of the committee, my name is Carl W. Goldbeck, president of Otto Konigslow Manufacturing Co. of Cleveland, Ohio, and I am testifying today as a member of the Alliance of Metalworking Industries

("AMI"). Also testifying today on behalf of AMI will be Charles H. Smith, Jr., chairman and chief executive officer of BIFCO Industries, Inc. of Cleveland, Ohio, and William P. Gentz, president of Gentz Industries, Inc. of Warren, Michigan. We have with us today David M. F. Lambert, Esq., special counsel to AMI.

The Alliance of Metalworking Industries represents a significant and critical segment of our national manufacturing industry. It consists of six member associations: The Forging Industry Association, the Metal Treating Institute the National Screw Machine Products Association, the National Tooling and Machining Association, the American Metal Stamping Association, and the Spring Manufacturers Institute. These six associations in turn represent 4,883 separate businesses, 98 percent of which are small businesses. These companies employ 880,250 employees and produce combined annual sales of $34.8 billion. Despite these large combined sales, members of the six associations are small businesses with an average of 46 employees per plant, producing average sales of $1.82 million per plant.

Despite the fact that many of our members are small businessmen, often in the lower tiers of the manufacturing process, they are essential not only to non-military manufacturing, but are also essential to the defense industry. Titanium forgings for aircraft landing gear struts, critical engine parts which are machined or stamped, and nose cones which are spun are only a few of the many examples of the products produced by our member companies. Prime contractors do not have the expertise nor is it economically feasible for them to buy the expensive and specialized machinery required to do this work.

We are deeply concerned about the tremendous burden that the Vinson-Trammell Act and the proposed IRS and DOD regulations would impose upon the small suppliers and lower tier manufacturing subcontractors that constitute our member associations and produce parts for aircraft and ships that may be subject to the act. For your benefit, we have attached to the written copy of our testimony a copy of our testimony before the IRS on March 12, 1980, relating to the problems that would result if the proposed IRS regulations become final. We request that this testimony be included in the record of this hearing, as well as the letters which we sent to the IRS on February 26, 1980, and DOD on March 25 1980, commenting on their proposed regulations to implement the Vinson-Trammell Act. We believe that the positions stated in those letters demonstrate the administrative unworkability and the inherent lack of economic justification for the Vinson-Trammell Act as it applies to lower tier subcontractors.

Mr. Chairman, you and the members of this subcommittee have for the first time in over three years provided us with the opportunity to address the problems we have had, and are now facing, with the prospect of final IRS and DOD regulations concerning the Vinson-Trammell Act of 1934. We respectfully call to your attention and the attention of Congress the serious dilemma caused by the inaction of the legislative and executive branches of our country with respect to this problem.

In 1976, when Congress decided not to extend the reporting requirements of the Renegotiation Act of 1951, it did so knowing that the lapse of the Renegotiation Act reporting requirements would trigger the onerous reporting requirements of the Vinson-Trammell Act. At that time Congress should have repealed the Vinson-Trammell Act. In that session and each succeeding session of Congress, legislation has been introduced to repeal or modify the Vinson-Trammell Act. Now, over three years later, a Congressional Committee is actively considering the question of repeal for the first time.

In that three-year period, Treasury and DOD, two of the senior agencies of the executive branch charged with developing and issuing regulations to implement the act, did not provide any guidance for our member companies to enable them to comply with the act. IRS, acting on behalf of Treasury, issued proposed regulations for the first time in October 1979. However, it is impossible for the small lower tier subcontractors that comprise most of our member industries to comply with the proposed regulations. The General Accounting Office, in its statement to this subcommittee on April 2, 1980, expressly recognized the problems faced by small businesses. Furthermore, we were pleased to note that the general accounting office supported the position we have taken with IRS and DOD, and now take with this subcommittee, when it stated, "the Vinson-Trammell Act is not workable." We hope our testimony today and the discussion in the IRS testimony and the letters which we are submitting to you today will

further clarify the extent of the burden on small business that will result if the implementation of the Vinson-Trammell Act is allowed to proceed.

RESERVES REQUIRED

Congress should be fully aware of a particularly harsh result of the failure of Congress, Treasury, and DOD to resolve the fundamental problems inherent in the act that now face our supplier industries. The result of this inaction is that the companies in our industries face uncertain and undefinable financial liabilities due to the retroactive application of the profit limitations of the Vinson-Trammell Act. As you know, most of our members are small, independently owned companies that can ill afford to show contingent financial liabilities on their financial statements. Moreover, our members will be required to set aside reserves in 1980 for potential, yet undefined, Vinson-Trammell liability for more than three years of booked profits, a liability which cannot specifically be determined under the act or the regulations and which will place an unwarranted and unjustifiable burden on our members at a time when they are already troubled by the highest inflation and interest rates in recent history.

PROBLEMS INHERENT IN THE VINSON-TRAMMELL ACT

There are problems inherent in the language of the Vinson-Trammell Act and there are additional problems in the rules which are proposed to implement the act. Only Congressional action can remedy the problems which are inherent in the act.

We believe that the Congress which enacted the initial legislation in 1934 never intended as broad a scope of coverage as is proposed in 1980. Under the Vinson-Trammell Act, all contracts and subcontracts for the manufacture of all or part of a complete naval vessel or military aircraft would be subject to reporting and profit limitation requirements, unless the amount involved is $10,000 or less. This $10,000 minimum contract for reporting purposes was established when the Vinson-Trammell Act was first proposed by Congress and enacted into law in the 1930's. However, since that time, inflation and the increase in sophistication in military hardware have caused the number of subcontracts and the associated paperwork involved to be more than fifty times the number originally contemplated by Congress. We anticipate that the companies who are members of our member associations would have to file an estimated 500,000 reports for individual contracts each year at an estimated cost of at least $200-$250 per report. The present backlog of reports due in October 1980 could be in excess of two million. These reports would have to be based on detailed records created especially for that purpose.

An additional problem inherent in the Vinson-Trammell Act that may be remedied only by Congressional action is that profits earned on the contracts and subcontracts for all or portions of naval vessels and military aircraft discriminate against those companies making those products by restricting profits to ten and twelve percent, respectively. When the 46 percent corporate tax rate is considered (a tax rate far in excess of the corporate income tax when the Vinson-Trammell Act was passed in the 1930's) an alarmingly small portion of sales remains to be reinvested or distributed to shareholders who have undertaken the risk of investment.

The profit limitations do not properly recognize the risks that small lower tier subcontractors have taken. These companies traditionally have invested considerable time and money in making many innovations necessary to remain competitive and in so doing have undertaken the risks inherent in operating small businesses. We believe the Vinson-Trammell profit limitatons would retard our members' efficiency, survival, and growth in several ways. First, the profits allowed by the Act do not provide the necessary general incentive for small businesses to undertake the risks of operation nor do they provide a proper incentive to perform efficiently. Second, the specific profit incentives generally recognized in the body of government procurement law as needed to encourage efficiency, the assumption of risks, innovation, and various other goals are lacking in the system of fixed profit limits established by the Vinson-Trammell Act. Profit limits are basically unnecessary in our industries. With nearly 20,000 competing companies, there is close to perfect competition in our industries.

Furthermore, it is impossible to identify and trace parts which may be subject to the Act. For instance, many of our members produce thousands of small

parts for aircraft engines. Even when it is known that the part will go into an engine, it is not known whether that engine will become part of a military aircraft, a commercial aircraft, or a spare part for either. It is impossible to make the required determination of the destination of the part in order to make the reports required by the Act and proposed regulations. It is an even greater burden to request our members to make this determination on a retroactive basis for all subcontracts completed subsequent to October 1, 1976, a determination that would require a review of records from before October 1, 1976. Moreover, in many cases, all or part of the profits that would be required to be paid back to the government under the Vinson-Trammell Act have been distributed as part of profit-sharing plans and are not available for repayment to the government under the Act.

THE VINSON-TRAMMELL ACT AS IMPLEMENTED BY THE PROPOSED IRS REGULATIONS

There are several hardships and inequities that arise from the IRS proposed regulations to implement the Vinson-Trammell Act. If these present proposals are adopted by the IRS and DOD in final rules, then there is an additional reason for this subcommittee to remedy the problems of Vinson-Trammell by supporting the repeal of the Act. These topics are summarized below, but we request that you carefully consider the discussion in our February 26 and March 25 letters to the IRS and DOD to more fully understand the difficulties presented by the proposed IRS regulations.

One major problem arising under the proposed regulations is that they threaten to exacerbate the traceability and identification problem of the lower tier subcontractors that is inherent in the Vinson-Trammell Act. Related to the traceability problem is the problem arising due to the inadequacy of the records maintained by our member companies. For example, a February 1980 survey of the membership of the National Tooling and Machining Association showed that, although they have adequate records for tax reporting, 98 percent of the association's members do not have adequate records to supply the financial data back to October 1, 1976, necessary for Vinson-Trammell reporting.

A second major problem is that the proposed rules would require that all Vinson-Trammell reports be completed in accordance with the cost principles of the cost accounting standards and defense acquisition regulation, section XV. Because the companies forming our member associations primarily produce commercial goods, or else produce goods only under contracts that are exempt from cost accounting standards, our member companies do not have accounting systems that conform to CAS and DAR XV. A typical small businessman in this country uses a basic accounting system which tells him if he is making or losing money. It is no way remotely as sophisticated as those accounting systems required to comply with CAS and DAR XV. In fact, many of our members do not even have cost accounting systems. To comply with the proposed regulations would necessitate the complete restructuring by these companies of their accounting sytem and the retroactive recreation of cost data to October 1, 1976. Moreover, certified public accountants throughout the country who audit our member companies may be unfamiliar with CAS and DAR XV.

The accounting rules in the proposed IRS regulations create an additional problem. For example, the provision in DAR XV that disallows interest expense as a cost in the determination of profits is unrealistic in today's business environment. Most of our members are required to purchase machinery and inventory on credit and, especially in light of modern day interest rates and machinery costs, interest expense is a real and necessary cost of doing business that clearly reduces a company's real profits.

Other problems with the Act that directly concern our members and are more fully covered in the letters to the IRS and DOD include: The unjustified charging of interest and penalties for failure to file, the record retention requirement of the proposed rule, the definition of a complete naval vessel or military aircraft, and the unreasonable burden of proof placed on small lower tier subcontractors who place many purchase orders for less than $10,000.

LEGISLATIVE ALTERNATIVES

There are several bills pending in Congress to repeal or modify Vinson-Trammell that would remove or ease the burden of Vinson-Trammell on lower tier subcontractors who are small businesses.

We support the Lugar/Cranston bill, S. 1687, which is currently pending in this subcommittee. That bill would repeal the Vinson-Trammell Act retroactivity to September 30, 1976; thereby eliminating all the problems discussed in this testimony. In fairness to all businesses, this is the piece of legislation that should be passed as the Vinson-Trammell Act is unnecessary, economically burdensome, and inappropriate in today's military-industrial environment.

If it is not legislatively feasible to repeal the Vinson-Trammell Act, and remove the burdens its implementation would present, we support legislation that would effectively reduce the burden. As an alternative to repeal, we support S. 2331, which is identical to the Patterson bill (H.R. 5433), if certain changes are made to correct its problems. S. 2331 repeals the Vinson-Trammell Act retroactively to September 30, 1976, and substitutes a more reasonable contract coverage. S. 2331 creates a new profit limitation for certain prime contracts and first tier subcontracts over $5,000,000 which are awarded without competition, and therefore would effectively exempt most of our members. However, S. 2331 as currently drafted presents problems which have been discussed in previous testimony before this subcommittee, including the vagueness of certain definitions in the bill. In addition, we concur with GAO's position regarding the appropriate dollar threshold for contracts and subcontracts subject to profit limitations. GAO suggested in its testimony before this subcommittee that the dollar threshold for profit limiting legislation should be raised to $10 million and should be indexed to the rate of inflation.

If the subcommittee finds it impractical to repeal Vinson-Trammell or adopt S. 2331, we would reluctantly support the Pell bill, S. 2232, if properly modified. The Pell bill does not change the profit limitations or reporting requirements for contracts or subcontracts covered by Vinson-Trammell, but it raises the exemption under the bill for contracts and subcontracts for military aircraft to one million dollars. We could only support the Pell bill if it were modified to increase the threshold to five million dollars and amend 10 U.S.C. § 7300 to raise the threshold for contracts and subcontracts for naval vessels, as well as aircraft. If modified, the Pell bill would eliminate a very high percentage of contracts which are not significant in size from the present Vinson-Trammell coverage and would make the administration of the act somewhat more feasible. The IRS estimates it would need 1,500 more agents to administer the Vinson-Trammell Act under its proposed rules. If modified, the Pell bill would probably reduce the number of reports by 85–90 percent and greatly reduce the government's and industry's administrative costs. However, for contracts large enough to be covered by the Pell bill, all of the problems of Vinson-Trammell discussed above would remain; accordingly, we support the Pell bill only as a last resort if Congress feels it is necessary to continue to operate under the Vinson-Trammell Act.

CONCLUSION

We appreciate the opportunity to appear at these hearings to consider the troublesome issues raised by the Vinson-Trammell Act. We sincerely hope that you will recommend repeal of the Vinson-Trammell Act because it is unworkable, inequitable, and unreasonable. If repeal is not practical at this time, then we hope this subcommittee will consider the adoption of a modified version of the Patterson bill or, if it is the only acceptable alternative, a modified form of the Pell bill in order to alleviate the difficulties of the Vinson-Trammell Act that we have discussed today. At the very least, if no legislative action to repeal or amend Vinson-Trammell is possible at this time, the effective date of the Vinson-Trammell Act reporting requirements should be suspended retroactively to October 1, 1976, and prospectively to late 1981 to provide Congress an opportunity to act on the pending legislative proposals which would repeal or amend the Vinson-Trammell Act.

We would be pleased to respond to any questions you may have concerning our testimony today.

ALLIANCE OF METALWORKING INDUSTRIES

Gentlemen, I am Carl W. Goldbeck, president of Otto Konigslow Manufacturing Company of Cleveland, Ohio, and am testifying today as a member of the Alliance of Metalworking Industries ("AMI"). With me today is David M.F. Lambert, Esq. We appreciate the opportunity to further supplement our com-

ments submitted to you in our February 26, 1980, letter commenting on the Internal Revenue Service's ("IRS") proposed regulations implementing the Vinson-Trammell Act of 1934.

The Alliance of Metalworking Industries represents a significant segment of our national manufacturing industry. It consists of six member associations: The American Metal Stamping Association; The Forging Industry Association; The Metal Treating Institute; The National Screw Machine Products Association; The National Tooling and Machining Association; and The Spring Manufacturers Institute. All but approximately 2 percent of our members are small businesses. The members of the associations represented by AMI have 888,250 employees in a total of 19,146 separate plants, all of which produce combined annual sales of 34.8 billion dollars. The members of the six associations are small businesses with an average of 46 employees per plant, producing average annual sales of 1.82 million dollars per plant.

In considering the adoption of any regulations implementing the Vinson-Trammell Act, you should recognize that our member associations represent companies which are typically second to fourth tier large volume suppliers of a wide variety of products used in assemblies for commercial or defense end products, including ships, aircraft, and spare parts for ships or aircraft.

Many of the products produced by our member companies are ultimately used in defense contracts which may be subject to the Vinson-Trammell Act. Because a large but undetermined number of those products may have become subject to the act subsequent to October 1, 1976, we are tremendously concerned about the extensive and costly administrative burdens created by the act and the proposed IRS regulations and particularly the impact compliance with those regulations will have on small businesses. In several significant areas, we believe the IRS regulations actually exceed the statutory limits of the act. We are aware of the many technical and legal problems in these proposed regulations and concur with the positions taken by the Council of Defense and Space Industry Associations ("CODSIA") in its comments to the IRS on the proposed regulations.

After careful analysis of the act, we do not see how any implementing regulations could be written that could effectively be applied to the small companies in the industries we represent. For that reason alone, we believe that the Vinson-Trammell Act of 1934 is outdated and should be repealed.

Since the proposed regulations will have a specific impact on small companies represented by our member industry associations, we would like to call your attention to some of the problems created by the regulations and highlight some of the severe administrative burdens these regulations will place on the six industries which we represent.

THE PROPOSED ACCOUNTING RULES CANNOT BE IMPLEMENTED BY SMALL SUBCONTRACTORS

We believe that section 160.9 of the proposed IRS regulations requiring the application of DAR XV and cost accounting standards in establishing cost of performance is the most glaring example of the unreasonable burdens created by the regulations. Because of their small size, the companies comprising our industries may not be able to comply with the proposed accounting rules. In the event compliance is required, there will be a strong incentive for our members to refuse necessary future defense work that may be subject to the act. The severity of the compliance problems increases due to their proposed retroactive application to all purchase orders completed after October 1, 1976.

Since the majority of the sales made by the industries and companies forming our member associations are commercial, few, if any, of these companies have accounting systems that conform to DAR XV and cost accounting standards, the allowable and allocable cost principles now required by the proposed IRS regulations. Furthermore, of those members doing defense work, most are presently exempt from and unfamiliar with cost accounting standards. The companies comprising our members are basically small family-owned businesses which use a variety of accounting systems for their fixed priced purchase orders. All of the accounting systems qualify for income tax purposes even though they may not be, or previously have been, required to comply with government contracting cost policies.

In light of the fact that the act, as now written, is applicable to all contracts over ten thousand dollars, a substantial number of the 19,000 companies repre-

sented by our industry will be forced for the first time to adopt, retroactively and prospectively, the complex allocability standards of the costs accounting standards board in order to obtain a small percentage of the government defense subcontract business. This added burden will prevent these companies from seeking government defense subcontract business since the cost of restructuring their accounting systems will far outweigh any benefits to be achieved by government contracts. We believe that it is not necessary and is inequitable to impose on small business the need to use cost accounting standards for Vinson-Trammel Act reports.

DOD's proposed comments to IRS alleviate some of the problems, and we firmly believe that the Federal income tax rules would produce a more accurate statement of profits for our industries. Since DAR XV does not allow for the deduction of certain legitimate costs of doing business, such as interest expense, the application of this standard on allowable costs will result in an inflated and unrealistic profit level when, in fact, the profits realized for tax purposes are less.

Additionally, the IRS and DOD approach to contract-by-contract reporting, as set forth in the proposed regulations, would not recognize normal traditionally recognized start-up costs. For example, the IRS regulations, as proposed, would not allow start-up costs charged to first production orders completed prior to October 1, 1976, on purchase orders entered into and completed in subsequent taxable years.

An additional problem created by the proposed accounting rules relates to their retroactive application. By forcing the members of our associations to now provide cost information for literally millions of purchase orders completed after October 1, 1976, the IRS is unjustifiably penalizing our members who, in the absence of any directions from the government, have used their traditionally acceptable accounting methods in identifying costs and profits on individual purchase orders. To now impose such a burden on these companies is unreasonable, since they would have to retroactively reconstruct and modify their accounting systems to comply with these new accounting rules.

Few of the companies comprising our member associations could successfully and accurately account retroactively for the costs and profits of those purchase orders subject to the act. The administrative burden would be so extensive and costly that it would seriously impair their ability to continue functioning on a daily basis.

IT IS IMPOSSIBLE TO IDENTIFY OR TRACE PARTS WHICH MAY BE SUBJECT TO THE REGULATIONS UNDER THE PROPOSED DEFINITION

Since most of the companies comprising our membership are third and fourth tier subcontractors making millions of parts used in both commercial and defense end products, it will be impossible for these companies to identify or trace the parts they have produced through the various higher subcontracting tiers, manufacturing levels, and assembly processes in order to ascertain whether that individual part, produced under purchase orders, ultimately became part of a completed new naval vessel or military aircraft. As discussed previously, to now identify millions of small purchase orders for many millions of parts in contracts that the companies comprising our member associations have entered into since October 1, 1976, is an impossible task. Since these companies, their customers, and their suppliers did not have knowledge that the IRS and DOD intended to promulgate a regulation based on a determination of the end use of the part, the identification of the ultimate end use of each part has not been considered as necessary for the past three and one-half years.

To impose liability for failure to collect information when these companies were not aware that such reports would now be required is unconscionable. Because of the extensive quantities and variety of parts produced by these companies since October 1, 1976, it would be exceedingly time consuming and expensive for them to even attempt to trace each part produced under individual subcontracts or purchase orders to its ultimate end use, assuming that such tasks are even possible.

Even if the retroactive application of the act was eliminated in the regulations, the prospective tracing of end uses would be extremely difficult. It would be necessary to trace each part through upper tier subcontractors and then through the prime contractor to determine if the end use of the part was incorporated in a completed ship or aircraft or if it became a spare part. As mentioned previously, many of the products produced by these companies may be included in

either military or commercial end products. The proposed regulations do not address or correct this traceability problem. Because of this complexity, no final regulations should be published and no reports required until lower tier small business subcontractors are provided with workable, practical, and efficient directions to trace the end uses of their products subject to the act.

As others will mention, we question if the proposed section 100.12 is feasible or was intended by the drafters of the act.

RECORD RETENTION REQUIREMENTS ARE NOT PRACTICAL

Section 100.14(b) requires preservation of all relevant records until the IRS deems them no longer material to the administration of the act. Since there had been no requirement of retaining records from the past three and a half years, many of the companies comprising our member associations have disposed of the records now required by the IRS and DOD. To impose liability under the proposed regulations for such a failure to retain these records when there was no indication that they would be required is unjustified.

In addition to this retroactive requirement, this section concerns us because it imposes open-ended requirements for the future preservation of records. Such a requirement is an undue and expensive burden for small companies. We see no reason why the proposed requirements under this section must exceed the general accounting office and the IRS rules for retention of records for tax purposes. We urge that alternatives be considered in place of this open-ended requirement. Amending this section of the proposed regulations will provide greater certainty for the vast number of companies who may be subject to the act and final regulations.

PLACING THE BURDEN OF PROOF ON SMALL LOWER TIER SUBCONTRACTORS IS AN IMPROPER EXTENSION OF THE REQUIREMENTS OF THE ACT

As written, section 100.3 would place the burden of proof on our small companies to demonstrate that purchase orders for parts under $10,000, which aggregate more than $10,000, were not separated merely to circumvent the act. Such a requirement once again places a severe administrative burden on small companies and should be deleted. If this proposed requirement is applied to purchase orders completed over the past three and a half years, our member companies could not meet the burden of proof and many purchase orders under $10,000 would then be subject to reporting. This is an improper extension of the requirements of the act. If the IRS had to impose such a harsh burden, it should have made it known at the time the Vinson-Trammell Act became operative in October, 1976.

INTEREST AND PENALTIES SHOULD NOT BE APPLIED UNTIL FINAL REGULATIONS ARE ADOPTED

IRS is not required by the act to impose interest or penalties on contractors who have not filed due to the lack of any government regulations. It is an unreasonable requirement to impose these sanctions under section 100.10 when final regulations have not been published. The financial burden could impair the future business operations of these small companies.

DEFINITION OF A COMPLETE NAVAL VESSEL OR MILITARY AIRCRAFT GOES BEYOND THE SCOPE OF THE ACT

Because the companies comprising our member associations produce parts, many of which are not integral parts of the naval vessel or aircraft, we are concerned that the proposed definition in section 100.1(b) are too vague. Defining a complete naval vessel or military aircraft to include "all articles necessary for the performance of its intended service" improperly expands the coverage of the act and imposes unwarranted identification burdens on lower tier subcontractors.

CONCLUSION

The alliance of metalworking industries sincerely hopes that the IRS recognizes that the proposed regulations in their present form impose, at virtually every point, severe and substantial administrative burdens on the industries and small businesses which we represent, particularly in view of the fact the proposed regulations will apply to lower tier subcontractors. We request that the

IRS, for the reasons stated above, recognize that the repeal of the act is necessary. We further request that the IRS withhold issuing any final rules until Congress has had an opportunity to express its position on the bills pending to repeal or modify the Vinson-Trammell Act.

STATEMENT OF THE NATIONAL TOOL, DIE & PRECISION MACHINING ASSOCIATION

I, Bruce N. Hahn, Manager of Government Affairs of the National Tool, Die & Precision Machining Association am delighted to be given the opportunity to testify regarding the Department of Defense's proposed comments on the IRS regulations implementing the Vinson-Trammell Act. The association represents 3,000 small business entities located in the United States of America who are in the business of designing and manufacturing special tools, dies, jigs, fixtures, molds, gages or special purpose machinery, and doing precision machining on a contract basis. Approximately twenty percent of our members, about six hundred businesses, manufacture products that may become part of complete naval vessels or military aircraft under contracts or subcontracts and therefore could be subject to the Vinson-Trammell Act. We are deeply concerned about the rules proposed by the Internal Revenue Service to implement the Act, and certain aspects of the proposed DOD regulations as they relate to the proposed IRS regulations. We are familiar with and concur with the positions which are being finalized by the Council of Defense and Space Industry Associations. Their comments will be submitted to the Internal Revenue Service and the Department of Defense.

Because our trade association represents many small companies who supply their products to various levels of upper tier contractors, we will take this opportunity to highlight the serious problems facing the members of our association if the IRS and DOD proposed regulations for implementing the Vinson-Trammell Act are adopted as final regulations. For this reason, we feel it is essential that DOD withhold any agreement to final regulations by the IRS and withhold final approval of the proposed DOD reporting form until Congress has had the opportunity to express its position on the bills presently pending that would repeal or substantially modify the Act.

COST IDENTIFICATION PROBLEMS

We support the direction of the changes that DOD has recommended to the IRS proposed rules. The areas which it selected for comment are of critical concern to our members. We feel that the alternative basis for accounting that DOD has selected is fair to our members, while still recognizing the interest of the government in recovering profits which may be considered to be excessive. Because many of our members are unfamiliar with Cost Accounting Standards and Section XV of the Defense Acquisition Regulation, they would be unable to meet the proposed requirement to retroactively identify parts subject to the Act and to then restructure their accounting systems as required if the IRS costing rules are adopted. It would also be difficult and expensive for them to prospectively install special accounting systems to collect costs on articles which may be subject to the Act.

These enormous administrative costs that would be imposed on our members would force small businesses to shoulder a disproportionate additional element of the cost of implementation of the Act with a resulting increase in prices to the government. Moreover, we believe use of Federal income tax rules will help derive a much fairer level of profits than the use of DAR, which fails to recognize certain legitimate costs of doing business, such as interest expense, that our members incur in their business.

Under the proposed rules, members who incurred start-up costs on early production runs prior to October 1, 1976, would be penalized on later production subject to Vinson-Trammell, because costs properly attributable to products machined in those years would not be allowed and profits subject to Vinson-Trammell would be artificially inflated.

CONTRACT COMPLETION

Our members are not satisfied with the proposed definition of contract completion. We agree with DOD that the present definition proposed by the IRS is unrealistic in the context of contracts or subcontracts for portions of one or

more navel vessels or military aircraft. DOD's proposal to define completion as the date of delivery of the last naval vessel or military aircraft is a worthwhile step toward achieving a workable alternative to the IRS definition. We believe, however, that the DOD's proposed definition does not consider the problems of lower level subcontractors and suppliers of materials and articles that may become a part of the complete ship or aircraft.

For lower tier suppliers, the incorporation of an article in a completed new ship or aircraft is not known, nor can it be known, at the time of delivery of the item to the customer. Under the present system of contracting, it will be impossible to accurately identify those articles and complete the required reports.

OTHER PROBLEMS

Although supporting DOD's suggested comments to the IRS, we were disheartened to see that DOD, which is knowledgeable on the problems which IRS has created, did not address or recognize many of the concerns of our members. DOD's statutory right to agree with the IRS on the method of determining profits under the Act gives it broad authority to address all the definitional and procedural problems created by the IRS proposed rules. We believe DOD should extend its comments on the IRS proposed reglations.

ADMINISTRATIVE PROBLEMS

Of critical concern to all our members is the immense problems involved in tracing parts supplied under contracts and purchase orders. The financial contract records of many of our members are insufficient for the preparation of Vinson-Trammell reports on contracts and purchase orders completed subsequent to October 1, 1976. We estimate that immediately upon the adoption of final rules, our members would be responsible for reporting on approximately 500,000 purchase orders dating back to October 1, 1976, and would need at least twelve months to comply with past reporting requirements alone. Because of the Government's delay in preparing and issuing effective regulations, it is patently unfair and would be tremendously burdensome, if not impossible, to now require our members to file reports on 500,000 or more contracts which have been completed during the past three years.

This unavailability of records only represents a part of the problem if the IRS and DOD proposed regulations are adopted. Even with proper records, it may be impossible, and if possible it will be very costly, to trace the machined goods that our members produce to determine whether their purchasers supply the goods under contracts or subcontracts for the manufacture of new U.S. military ships or aircraft, and if so whether the parts go into spares or replacements which are not subject to the Act, or, because many of the parts manufactured by our members also have commercial use, whether the parts are to become part of commercial ships or aircraft or some other commercial items. As difficult as this determination is to make at the time a part is delivered, it is more difficult to reach a mutual understanding as proposed by IRS at the time a contract is entered into. Unfortunately, because DOD has not raised this question DOD has implicitly agreed with the administrative practicability of these requirements proposed in the IRS rules. We hope that DOD will express its concern about this traceability problem to the IRS.

Another troublesome area which we believe DOD should address is the open-ended requirements as to the preservation of records. Many subcontracts and purchase orders which have been completed over the past three years have already been disposed of. As small businesses, our members should not be so burdened as there is no justifiable need for such a requirement. This proposal greatly exceeds present contractual requirements and IRS rules for retention of records for tax purposes. Acceptable alternatives would include the retention for a fixed term of years following contract or purchase order completion or retention beyond a specific term of years only for those contracts designated by the IRS or DOD as contracts currently under review.

PROBLEMS OF DEFINITION

Another area of concern is the proposed definition of a complete naval vessel and military aircraft as a "newly constructed naval vessel or military aircraft that has been furnished with all articles that are necessary for the performance of its intended service." This definition includes many items that are not an

integral part of the naval vessel or military aircraft such as missiles, rockets, fuel, spare parts, stores, and other similiar items. We do not believe it was Congress' intent in restricting profits on vessels or military aircraft to include these extraneous items and confuse and burden small businesses preparing reports.

JUSTIFICATION FOR CONSOLIDATED FILINGS

Finally, we believe that DOD should comment to the IRS on its failure to specify whether individual entities must each file separate Vinson-Trammell reports for purposes of profit limitation determinations, instead of permitting an entity to file consolidated reports with affiliated companies as allowed for income tax purposes. Our members recommend that this vagueness be clarified by applying the same rules to Vinson-Trammell reports as are applicable to consolidation for Federal income tax purposes. To do otherwise, would complicate the determination of the tax credit against excess profits in the event a contractor files consolidated tax returns but is required to determine excess profits for Vinson-Trammell as an individual entity.

CONCLUSION

It was a pleasure to be given the opportunity to testify at this hearing. The scheduling of the hearing and the receptiveness shown to comments and ideas indicate that DOD will recognize that the repeal of the Act is necessary and that, if it is not repealed, the implementation of Vinson-Trammell must be administratively acceptable to small businesses such as the members of our trade association. We also hope that because of DOD's interest in the problems created by Vinson-Trammell, it will withhold issuing its regulations and forms and oppose the issuance of any final rules by the IRS until such time as Congress has had the opportunity to express its position on bills pending to repeal or modify Vinson-Trammell.

Again, our sincere thanks for this opportunity to testify again.

Mr. STRATTON. Thank you very much.

In a general summary, I get the impression you would all favor the waiver provisions, and would favor repeal of Vinson-Trammell. I think, with the exception of Mr. Stewart and Mr. Hahn, you have not even suggested the possibility of some other type of legislation.

The point was made here by the GAO that they felt we needed some sort of legislation to replace it, to provide at least some monitoring of excessive profits. This would be primarily because so many of the people in the Defense Department, or contracts, that is, are sole source and are carried out without the competition. Therefore, you do not have the ordinary regulating procedures of the marketplace.

I wonder if some of you might comment on the suggestion that perhaps we might amend the legislation along the lines suggested by Mr. Patterson as a possibility, that is, of recognizing as somebody said that, if the American people had to vote on whether to eliminate this legislation or not, the chances are you would have a substantial vote against eliminating the remnants of some kind of profit control.

Mr. MCCLOSKEY. I would like to answer the last part. I think that was Admiral Rickover's suggestion.

I think if the American people knew the facts, they would vote overwhelmingly for removal of that control. I think the facts are that the cost of administering the program has exceeded the cost of the return to the taxpayer. I think that is the major issue that we are facing.

We are not objecting to the concept of a rational profit limitation, that is, if the cost of administering that were reasonable. Those costs get pushed down to many, many contractors and many, many sub-

ontractors. They produce an unreasonable burden in terms of record-
eeping. It does not really justify itself, that is, at least in noncrucial
imes when we are not at war.

Mr. HARR. Let me try to respond as bluntly and candidly as pos-
ible to your question. Bear in mind that I am speaking from a van-
age point of the large prime contractors in the airplane, missile,
nd space business, many of whom are names well known to the gen-
ral public, if only in terms of their large dollar volume of Govern-
nent contracts. They are companies that are in the defense business
nd have been for a long time, often with large commercial adjuncts
o the defense business.

These companies have been in the defense business to a substantial
legree, and they expect to stay there. Because of their experience, they
now exactly the degree of scrutiny and surveillance that is built into
he system under which they must operate internally as to auditing—
rofessional auditing, customer auditing, and the GAO auditing—
nd because of other still existing legislation. You spoke of sole-
ource procurement—but it is of great importance to understand these
ompanies' awareness of the keen competition in the defense business.
t that level of Government procurement, the competition is fierce
ecause you only have one customer. There is no place else to go.

If the United States does not buy your product, it buys the other
uy's. That is it. It is fiercely competitive on that basis.

One element of that competition is the repute in which your com-
any is held by the customer. It is a fancy way of saying that if you
ave got to live entirely or substantially on the approval of a single
ustomer, you are not going to run away with excess profits unless
ou decide that it is going to be your last big haul when you are going
nto the furniture business. You want to be around for the next time.

Also, nothing makes a better story on a slow news day than excess
rofits in defense procurement. So that I will not be misunderstood,
e really feel in this day and age, for reasons we have gone into
ntensely during hearings on renegotiation and in other related mat-
rs, that there is no true need for profit limitation.

That is not to say that we are unaware that there may be a political
eed for it, which is something that you all will have to be better
udges of than we can certainly be. We recognize that.

We are not for the Patterson bill. We see a lot wrong with it. We are
or repeal of Vinson-Trammell. We will certainly be as rational and
easonable as we can possibly be in supporting whatever legislation the
ommittee decides in its wisdom is necessary to the extent that we can.

I am trying to lay it on the line so that there will be no surprises
down the road.

Mr. STRATTON. Thank you.

You gentlemen are too young to recall this, but I remember in
World War II we had a case that was played up in Life magazine, the
Jack and Heinz Co. I do not know whether they were in Philadelphia
r Boston. I have forgotten exactly what they made.

According to the story they were making millions in profits, and
hey were handing out free vacations and what-have-you to all of
heir employees. There was a quirk in the contract somewhere, and as a
esult nobody caught what was happening.

I think this is the kind of thing this type of legislation has in mind. Maybe this could not happen again, but in terms of talking about what the American people would vote for, I think you would find—and I am not one of them who joins in—but I think you would find the American people would vote overwhelmingly to limit the profits of the oil companies today, if they had that opportunity.

It seems to me, if for no other reason than public relations, that defense contractors would want to have at least something that would make it clear they were not abusing their opportunities in pursuing Government contracts.

Mr. HARR. If I may, Mr. Chairman, I think I can speak for everyone at the table when I say that at no time in the process of considering this overall question in the past 3 or 4 years have any of us come out against controls or some measure of profit limitation in time of war. The point has been when you go back to a careful, steady, orderly procurement process, with all of its built-in safeguards, you have an entirely different situation than in time of war.

I am afraid from our part of the defense business that the public relations aspects in having to defend huge profits has never had any basis in reality because we have never had huge profits.

Mr. STEWART. I do not disagree with anything that has just been said, but I really believe that what you confront here is the reality of not being able to do justice to the issues that are involved in substitute legislation within the time period that you have in this Congress.

It should be emphasized, as we did, that the Patterson bill has problems. It will take you extensive time to surface them, to address them, and to make judgments on them. Similar proposals create problems.

The Defense Department, in addition, has not given the Congress a definitive statement of what problem Mr. Church is talking about. He says there is a very narrow set of contracts, where DOD does not feel that it can protect the public or the Government interest. But the definition of those contracts and the why as to the need for profit limitation have not been spelled out.

Sometimes as I talk to these very responsible people, I doubt if they know themselves what the real dimensions of the problem are. At least they are not on the record.

So in a nutshell, regardless of what the chairman and others may think about the possible need for substitute legislation, we should not rush into it. The Patterson bill is not a simple proposal. I do not know of any simple answers.

The Congress has not, in my opinion, largely because of some abdication of responsibility by the executive branch, gotten started with serious consideration of the substitute legislation early enough to permit you to enact it or reject it in the Congress. That is where I feel that you have to come out with this.

Mr. HAHN. I think Mr. Stewart is right from a practical and a political standpoint. In the time left in this Congress as to what can be done and what is vitally necessary, it is to pass some sort of a deferral so that a more complete investigation can be conducted in the next session of Congress.

Let me add one thing. I am speaking for the small subcontractors. We are completely in sympathy with the larger contractors. We think

that the Vinson-Trammell Act is unfair and unworkable for us, and it is unfair for them.

I have gone 9 yards with them through IRS hearings, DOD hearings, and working with the Senate Armed Services Committee. And from the standpoint of fairness, I think they are right. I think the preponderance of evidence demonstrates that the Vinson-Trammell Act should be repealed.

On the other hand, you have to deal with the political realities. An approach such as the Patterson bill would solve a lot of the problems. It would probably solve all of the problems from a small business viewpoint because I do not know of maybe one company in the entire six industries that has ever had a contract of over $5 million.

But if the technical problems in the Patterson bill were solved, it would reduce the reporting tremendously. It would be to a manageable level that actually could be followed by the IRS and DOD. From a practical standpoint, it would be more easily administered.

Another approach that might be considered is some sort of mechanism that could be put into effect in time of national emergency by the executive branch with or without the permission of the legislature.

Mr. STRATTON. Mr. Daniel?

Mr. DAN DANIEL. This is certainly no reflection on my chairman, because I do not reflect unfavorably on my chairman, but as I was sitting here today, I wondered why these men were sitting out there listening to their servants. Because, after all, they pay the salaries, but now I know why. I think it is good that you all came on last. You have given us a balance.

It is a balance for the record that we can take into account when we sit down to try to come out with something that will be workable. I am very grateful to all of you and the contributions you have made.

I know it has been a very trying day, but it has also been a trying day for us. We appreciate your contributions.

Mr. STRATTON. We will keep the record open for a week for other individuals who may wish to submit statements. I think we had one Member of Congress who was expected to be here and could not make it. That was Congressman Barnard.

Let me join in thanking you gentlemen for your patience and your help. You have added balance. We have a tough job to look at this entire subject. We are grateful for your help, and we hope to come up with the right answers.

WRITTEN STATEMENT OF HON. D. DOUGLAS BARNARD, JR., A REPRESENTATIVE FROM GEORGIA

Mr. Chairman, and members of the Armed Services Committee, I deeply appreciate this opportunity to testify on Chairman Price's bill, H.R. 7247, and to present my approach to replacing the Vinson-Trammell Act.

Although the Vinson-Trammell Act is antiquated, and has only reappeared because of a legislative quirk, it will have a real impact on the defense industry unless it is repealed rapidly. There is, however, a controversy about what to replace Vinson-Trammell with, and since it appears that it will not be resolved before the end of this Congress, I enthusiastically endorse your bill, Mr. Chairman, to waive the application of Vinson-Trammell to contracts ending before October 1, 1981.

This respite of over a year should allow Congress the time to fashion a replacement that meets the objectives of all those opposed to Vinson-Trammell. It is

not a permanent solution to the problem, as those contractors whose final payment will be made after the start of fiscal year 1982 will still have to comply with the law, but it does avoid the immediate problem of forcing most contractors to comply with an outdated law with no modern purpose.

It is absurd to subject defense industries of 1980 to a profits limitation that was last revised 41 years ago, at a time when nuclear power was a dream in one man's head and the age of the biplane had just ended. Recognizing this, the Internal Revenue Service has performed one of the few commendable feats of bureaucratic inertia. However, unless action is taken—and soon—an onerous burden will be placed on defense contractors at a time when once again our country is trying to rebuild its obsolete defenses.

Any defense supplier with a contract to provide any parts or furnishings for a new ship or aircraft will have to file a quarterly report to the Department of Defense, and an aggregate yearly report to the IRS for each contract with a value of over $10,000. The spectrum of articles to which the act could apply ranges from floor coverings to ammunition, from fuel to furniture, and from power plants to plumbing.

Since the regulations are statutorily based, they are assumed to be included in all applicable contracts despite the presence or absence of a contract clause. Virtually any company could be subject to the Vinson-Trammell Act and its implementing regulations.

Compliance costs will be high. A producer of such simple items as radios or ammunition will be forced to keep three sets of books: one for aircraft related sales, one for ship related sales, and one for other defense contracts. In addition, the estimated 10,000 contractors who will come under this act will have to file an average of 50 reports apiece per year at a cost of 8 hours labor and $160 each to complete. This $80 million total filing cost will be passed on to the government in the form of higher prices, and by the time the annual 500,000 reports have been processed, the total annual cost of Vinson-Trammell may reach as high as $240 million without any guarantee of recovered profits to offset the cost.

What is worse, Vinson-Trammell is totally unnecessary. Times have changed for businesses since 1939, when the corporate tax rate was 13¾ percent of 46 percent, deflation rather than inflation was the major economic worry, and the Departments of War and the Navy had no mechanisms to audit costs of defense contracts.

Since 1939, the Truth-in-Negotiations Act (Public Law 87–653) has been passed; a powerful sanction which promotes sound and open negotiations between government and defense contractors. In addition, the Cost Accounting Standards Board, authorized by the Cost Accounting Standards Act (Public Law 91–379), has accomplished pioneering work in establishing common standards of accounting for contract costs. As a result, the government can better determine what costs it is actually paying for in a negotiated contract.

Procurement officials and contracting officers are highly trained competent individuals today. Contracting officers have the power to conduct an on-site audit at any time during the performance of a contract. Abuse of the contract process results in refunds of both costs and profits. The work of the Defense Contract Audit Agency and the Defense Contract Administration Service has been so efficient that they superceded the Renegotiation Board as the chief watchdog of excess profits long before that agency was eliminated.

Vinson-Trammell, on the other hand, deals totally with an after-the-fact situation. In fact, since costs can always be charged against profits on the contract, thus lowering the profits, it is an open invitation to inefficiency and waste.

In the face of this evidence, it is the overwhelming opinion of legislators in both Houses of Congress that Vinson-Trammell needs to be eliminated or updated. The major controversy comes in deciding what form the repeal should take. Proposals in the House alone range from a flat repeal to a repeal including placing the old Renegotiation Board on a wartime standby basis, and from reenacting the Renegotiation Act to adding another set of bureaucratic price limitations in place of Vinson-Trammell. There are valid arguments for all of these proposals, and I would like to complement my colleagues on their work.

I do, however, have serious reservations about imposing even more regulations and limitations on an already over-regulated industry. Profit limitations in any form will inhibit productivity by removing both the incentive and financial means to provide for a productive plant and equipment.

Regardless of incentive bonuses built into profit limitations, the net result will be to reduce productivity and to increase administrative costs. The place for the

government to ensure it is not getting cheated in time of peace is during the initial negotiations process, and not after the contract has been completed. After the fact profit collections are justified only if the volume of noncompetitive contracts is so great that they cannot adequately monitor costs and profits. Under normal peacetime conditions, this should not occur.

To meet possible wartime needs, however, I have proposed another alternative: H.R. 6483.

Our experiences in both World War II and the Korean War have shown us that in a major war, the huge amount of defense contracts that are necessary require special measures to prevent war profiteering. Thus, the simple repeal of Vinson-Trammell may leave any future Congress with the need to institute some sort of profit limitations.

If standby controls are needed, however, changing times may well make any set mechanism to collect excess profits obsolete well before they are needed. This is the experience we are facing today in the effects of the Vinson-Trammell Act on a defense industry 46 years after it was passed, and was one of the reasons for allowing the Renegotiation Board to expire last year.

These limitations can best be seen in Vinson-Trammell, where such weapons systems as missiles, jet aircraft, radar and nuclear warheads were not imagined or covered. Can any set of standby controls that we prepare today pretend to cover whatever new advances the future brings. In addition, economic conditions have changed substantially.

In 1939, Vinson-Trammell had a floor of $10,000, below which the provisions would not apply. This level was set so that small contractors would not face the burden of compliance costs. The 1951 Renegotiation Act, recognizing domestic inflation and the higher costs of technologically advanced weapons systems, raised the floor to $1 million. The two bills proposed in the House which would substitute peacetime profit curbs for Vinson-Trammell, have floors of $3 million and $5 million respectively.

Unfortunately, in a period of rapidly advancing technology and soaring inflation, even if it recedes from its current levels, who could accurately predict a logical floor for even five years in the future. Any specific standby controls are likely to be more of a hinderance than a help to a future emergency situation. Instead, it would seem more logical to leave in place just the bare authority for regulations dealing with excess profits, along with certain requirements the regulations must meet.

This is the approach of H.R. 6483. It requires the President in time of war to recommend to Congress regulations to control excess profits on defense contracts if he determines they are necessary.

The regulations must include a standard for determining excess profits, and set a floor for coverage of contracts so that small contractors are not unfairly burdened, and the government is not faced with huge administrative expenses. Once a standard for excess profits has been set, a specific procedure for determining them that can be objectively applied to all contracts above the threshold is required. Finally, the United States Court of Claims is given exclusive jurisdiction over claims, so that an appeals mechanism will protect against unfair actions on the part of either the government or the contractors.

Since these regulations can only be proposed in time of war, when rapid action may be necessary, an expedited approval procedure by Congress is provided for. However, Congress still has the final control, as either House may veto them within thirty days after they are proposed. Finally, to prevent another Renegotiation Board from existing long after its usefulness has ended, the regulations can only remain in force for a maximum of five years, unless they are extended by a positive vote of both Houses of Congress for a maximum period of one year at a time.

This simple structure will allow maximum flexibility for future Congresses to mold needed emergency regulations to the needs and problems of their times. At the same time, H.R. 6483 mandates that these regulations be fair and impartial, so that both the government and defense contractors will be treated without prejudice. No detailed structure to get out of date and obsolete is required, and we do not limit the future to the economic assumptions of today.

In conclusion, Mr. Chairman, I heartily endorse H.R. 7247 as a necessary measure to prevent the Vinson-Trammell Act from being enforced, and hope that the Armed Services Committee will take speedy action on it.

WRITTEN STATEMENT OF MILTON D. STEWART, CHIEF COUNSEL FOR ADVOCACY FOR SMALL BUSINESS

U.S. GOVERNMENT,
SMALL BUSINESS ADMINISTRATION,
Washington, D.C., July 2, 1980.

HON. SAMUEL S. STRATTON,
Chairman, Subcommittee on Investigations, Committee on Armed Services, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: I would like to thank the Committee for extending me the opportunity to present my views on proposed legislation intended to waive the applicability of the Vinson-Trammell Act (V–T) from October 1, 1976, through September 30, 1981.

As you may be aware, the Office of the Chief Counsel for Advocacy for Small Business was created by Public Law 94–305 to serve as a focal point for small business complaints regarding Federal agency policies, and to represent the views and interests of small business before the Federal Government. I must stress that the views I am expressing on this subject are my own and not necessarily those of the Administration or the Small Business Administration.

On May 2, 1980, I submitted a statement to the Senate Armed Services Committee, Subcommittee on Procurement Policy and Reprogramming, on the defense contractor profit limitations of V–T and their onerous impact on small business. My statement to the Senate subcommittee is included for the record. Since the present hearing is limited to the V–T waiver provisions contained in the Defense Authorization Act as reported out of the Senate Armed Services Committee and the bill introduced by Congressman Price (H.R. 7247), I would like to add a few brief thoughts to that testimony relevant to the issues of this hearing.

It is clear that most small businesses would be unable to comply with V–T if implemented. Many small business contractors are unable to determine which contracts are for all or part of a naval vessel or military aircraft and hence subject to V–T. Furthermore, small business accounting systems generally cannot provide the data necessary to comply with V–T. The traceability and accounting problems are greatly multiplied if V–T were to be applied retroactively to October 1, 1976 as is required if no legislative action is taken.

The passage of nearly 4 years without implementation due to the expiration of the Renegotiation Act of 1951 has not been without its consequences. As a result of this passage of time, many small businesses have been forced to include contingent liabilities for amounts potentially due under V–T on their financial statements. This has made it extremely difficult for them to obtain needed financing. Furthermore, due to the accounting and traceability problems previously noted, it is almost impossible for small businesses to comply with V–T retroactive to its October 1, 1976, reincarnation.

For these reasons and others, all of which are detailed in my May 2, 1980 statement, some sort of legislative action with respect to V–T is needed now. Although we would prefer to see Congress deal with the entire profit limitations issue now, we recognize that this may not be possible given the present legislative calendar. Assuming a long-term legislative solution to defense contractor profit limitations is impossible at this time, we endorse the 5-year waiver approach of H.R. 7247 and the Defense Authorization Bill as reported out of the Senate Armed Services Committee with a technical modification relating to the cutoff date as described below.

H.R. 7247 provides for a waiver of V–T for contracts "with respect to which final payment is made before October 1, 1981, or to any subcontract of such a contract." The Defense Authorization Bill as reported would provide for a waiver of V–T "to any contract or subcontract for which performance was completed during the period October 1, 1976, to October 1, 1981."

As I understand, the intent of these provisions is to provide a 5-year moratorium from V–T. These provisions would not accomplish this. Causes beyond a contractor's control often delay final payment and contract completion. We have seen many cases where the Government has failed to pay sums due contractors in a timely manner and of Government caused delays in performance. As a result, a contractor bidding on a solicitation today would be unable to determine if the resulting contract would be subject to V–T.

Such knowledge is especially important for small business contractors. V–T requires the computation of excess profits on a per-contract basis. Unlike larger

firms, most small businesses do not have elaborate cost accounting systems that readily compute profits on a per-job basis. A prudent small businessman bidding on a contract would have to put an additional amount in his bid to cover the contingency of having to retroactively alter his accounting system to comply with V–T. This would lead to higher contract prices. Such a provision would also work to the advantage of large firms having cost accounting systems in place in that these firms would not have to put a contingency in their bid for retroactively changing their accounting systems if V–T were implemented. This would fly in the face of the long-established congressional policy codified in 15 U.S.C. Sections 631–647 of assisting small business firms and assuring that they receive a fair proportion of Federal contracts.

Knowledgeable small businesses may decide to forego defense work rather than roll the dice on V–T applicability to future contracts. This may lead to a dangerous erosion of the defense industrial base in a time of increased international tension.

For these reasons, we recommend that Congress extend any V–T waiver to include all contracts or subcontracts awarded prior to October 1, 1981. If Congress is concerned that an award date cutoff would exempt large multi-year systems procurements, this more liberal cutoff date could be limited to contracts or subcontracts awarded to small businesses as defined in SBA regulations. A lesser acceptable alternative would be to limit the applicability of such a cutoff date to contracts and subcontracts below a certain dollar level that would effectively exclude small business. In the Senate hearings on V–T, GAO in its statement recommended a dollar threshold of $10 million for exempting small firms from V–T. We would find this figure accepetable for this purpose.

Thank you for providing me with the opportunity to present my views. If you have any questions or if we can be of assistance, please have your staff contact Mr. Paul J. Seidman, my Assistant Chief Counsel for Procurement. He can be reached at (202) 653–0717.

Sincerely,

MILTON D. STEWART,
Chief Counsel for Advocacy for Small Business.

Enclosure.

STATEMENT OF MILTON D. STEWART, CHIEF COUNSEL FOR ADVOCACY, U.S. SMALL BUSINESS ADMINISTRATION

[Before the Senate Armed Services Committee, May 2, 1980]

Mr. Chairman and members of this committee: I would like to take this opportunity to thank the Committee for extending me the opportunity to present my views on the defense contractor profit limitations of the Vinson-Trammell Act (V–T) and their potential impact on small business defense contractors.

As you may be aware, the Office of the Chief Counsel for Advocacy for Small Business was created by Public Law 94–305 to serve as a focal point for small business complaints regarding Federal agency policies, and to represent the views and interests of small business before the Federal Government.

SUMMARY

The Office of Advocacy has received many expressions of concern from small business about the impending implementation of V–T. As a result of our dialogue with these small business contractors and our own investigation, we believe that V–T, if implemented in its present form, would cost more to administer than would be recovered in excess profits and would result in a dangerous erosion of the defense industrial base. Foreseeable results would be:

A horrendous paperwork burden for both the Government and small business contractors;

A multiplier effect, which would result in the dollar amount of small business subcontracts subject to V–T exceeding the amount of prime contract awards subject to V–T;

An inability of small business subcontractors to determine which contracts are for part of a complete naval vessel or military aircraft and hence subject to the Act, especially on a retroactive basis;

An inability of small business accounting systems to provide the accounting data necessary to comply with V–T, especially if V–T was applied retroactively.

The passage of nearly four years without implementation since V–T became applicable due to the expiration of the Renegotiation Act of 1951 has not been without its consequences. As a result of this passage of time:

Many small businesses have been forced to include contingent liabilities for amounts potentially due under V–T on their financial statements. This has made it extremely difficult for them to obtain needed financing;

It is almost impossible for small business to comply with V–T retroactively.

As a result of these problems, we recommend that Congress repeal V–T retroactive to its October 1, 1976 resurrection. If Congress concludes that a profit limitation is needed, small business should be excluded or, in the alternative, the dollar threshold for applicability should be set sufficiently high to achieve this result. GAO, in its statement, has recommended a dollar threshold of contracts over $10 million that would be adjusted for inflation.

BACKGROUND

The Vinson-Trammell Act, which was enacted in 1934, imposes profit limitations on contracts and subcontracts for the construction or manufacture of naval vessels and military aircraft. The applicable profit limitation is 10 percent of the total contract price for naval vessel contracts and 12 percent for military aircraft contracts. The Act exempts from its profit limitations contracts and subcontracts of $10,000 or less.

Vinson-Trammell has been in effect very few of the 46 years since its 1934 enactment. It was suspended during World War II because it was perceived as an ineffectual profit limitation that was hindering the defense effort. A 1943 law review article describes V–T's wartime repeal and its failure as a profit limitation as follows:

"The Vinson-Trammell Act, and its amendments must be written off as a failure, even in peacetime, in accomplishing any effective profits control. According to a statement of the Treasury Department, the net amount assessed under the Act on contracts for Navy vessels and aircraft up to August 31, 1942, was roughly $7,450,000, and on Army aircraft contracts for the same period, $70,000. As plans for vastly increased procurement of war munitions were made after the fall of France in 1940, it was established that the Vinson-Trammell Act limitations were making shipbuilders and aircraft manufacturers reluctant to enter into contracts and were definitely delaying the war program. Investigations of profits on the contracts of the armed forces, after suspension of the Vinson-Trammell Act, have quite conclusively established that the Act was ineffectual to prevent very large profits to certain contractors." [1]

V–T was effective for only two years after World War II. It was suspended from 1948–1951 by the Renegotiation Act of 1948 as amended and from 1951 to September 30, 1976, by the Renegotiation Act of 1951. Although technically in effect since the September 30, 1976 expiration of the Renegotiation Act of 1951, the IRS has granted six extensions of the due date for contractor filings. The present due date is October 15, 1980.

Recently the IRS and DOD have published proposed V–T regulations for comment in the Federal Register and have held hearings on the proposed implementation. The Office of Advocacy perceives severe financial and administrative hardships for small business if the Act is made effective, and I urge this Committee to provide legislative relief.

V–T WOULD IMPOSE A HORRENDOUS PAPERWORK BURDEN ON SMALL BUSINESS CONTRACTORS AND THE GOVERNMENT

The implementation of V–T would seem to be inappropriate at a time when the Administration has by Executive Order requested all Federal agencies to make a concerted effort to reduce the paperwork burden on small business. For fiscal year 1980 alone, it is estimated that 9,900 firms [2] would have to file approximately 50 reports each with DOD and the same number to Treasury—a total of almost 1 million forms. Where adequate accounting data is avail'abl

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[1] Hensel and McClung, "Profit Limitation Controls Prior to the Present War," 10 Law and Contemporary Problems 187, 204–205 (1943).

[2] This figure is for both large and small firms. We were unable to obtain statistics isolating small firms.

which for the reasons later described is most likely not the case for small businesses, it would take approximately 8 hours per form of professional time to gather up the data and use it. The estimated cost of professional time is $15 per hour. Thus the aggregate cost for business to comply with V–T for one year would exceed $120 million.

It should be emphasized that this estimate is for fiscal year 1980 alone. Assuming V–T is retroactively implemented for fiscal years 1977, 1978, and 1979 as is required in the absence of a retroactive statutory repeal, contractors would incur similar compliance costs for these years. In fact, the cost of compliance per form for these earlier years is likely to be greater due to a lack of adequate accounting data. Thus the cost of compliance for these earlier years could conservatively exceed $500 million and may in fact be greater even than that.

The cost of implementation would not fall on the private sector alone. It is my fear that a new army of bureaucrats will be hired by DOD and IRS to enforce these paperwork requirements against small business. This seems particularly inappropriate given the present initiative toward less rather than more paperwork. Additionally, the implementation costs would likely exceed the amount of excess profits recovered under V–T.

DUE TO A MULTIPLIER EFFECT THE DOLLAR AMOUNT OF SMALL BUSINESS SUBCONTRACTORS SUBJECT TO V–T WOULD EXCEED THE AMOUNT OF PRIME CONTRACT AWARDS SUBJECT TO V–T

Due to a multiplier effect the dollar amount of small business subcontracts subject to V–T would likely exceed the dollar amount of prime contracts awarded to larger firms. The dollar amount of prime contracts subject to V–T for fiscal year 1980 alone is approximately $15 billion. For fiscal years 1977–79, which would be of concern if V–T were to be applied retroactively, the dollar amount is approximately $39 billion.[a]

DOD statistics show that 80 percent of the dollar amount DOD prime contracts subject to V–T are subcontracted and that 50 percent of this subcontracting is with small business. Although subcontracting figures are not available below the first tier, it is clear that the percentage subcontracted decreases and the percentage of subcontract awards to small business increase at lower tiers. Assuming that the percentage subcontracted is 70, 60, 50, and 40 percent for tiers two to five and that the percentage subcontracted to small business is 60, 70, 80, and 90 percent for these tiers, $20.5 billion of subcontracts would be awarded to small business for $15 billion in prime contracts subject to V–T. This is illustrated by the chart below.

ILLUSTRATION OF MULTIPLIER EFFECT ON SUBCONTRACTS FOR $15,000,000 FISCAL YEAR 1980 CONTRACTS SUBJECT TO VINSON-TRAMMELL

[Dollar amounts in billions]

	Amount	Percent subcontracted	Percent of subcontracts awarded to small business	Amount of subcontracts awarded small business
Subtier:				
1	$15.0	80	50	$6
2	12.0	70	60	5.04
3	9.6	60	70	4.03
4	8.0	50	80	3.2
5	6.4	40	80	2.3
Total				20.5

MANY SMALL BUSINESS SUBCONTRACTORS WOULD BE UNABLE TO DETERMINE WHAT CONTRACTS WERE FOR ALL OR PART OF A NEW NAVAL VESSEL OR MILITARY AIRCRAFT AND HENCE SUBJECT TO V–T, TRACEABILITY PROBLEMS MUCH GREATER IF V–T IS APPLIED RETROACTIVELY

V–T requires contractors to submit reports and pay any excess profits on all contracts or subcontracts for all or part of any naval vessel or military aircraft.

[a] Facts obtained from interviews with Pentagon officials, and informal review of budget line items.

small businesses generally participate in naval vessel or military aircraft contracts as subcontractors. Small business subcontractors, especially those below the first tier, are often not in a position to determine whether the items they are providing are to become a part of a new naval vessel or military aircraft. Often a large prime contractor or higher tier subcontractor will purchase an item for general stock. It may ultimately be incorporated in a new naval vessel or military aircraft or on the other hand be used for commercial business or sold to the Government as spare parts.

It is patently unfair for the Government to require subcontractors to trace the ultimate destination of the items they sell, especially when the buyer may be unable to tell them at the time of the transaction. If V–T is applied retroactively, as is required in the absence of legislative action, compliance may be practically impossible in many cases.

SMALL BUSINESS GENERALLY LACK THE ACCOUNTING SYSTEMS NECESSARY TO COMPLY WITH V–T, ESPECIALLY RETROACTIVELY

V–T requires the computation of excess profits on a per-contract basis rather than the annualized basis on which most small firms compute their earnings. Unlike larger firms, most small businesses do not have elaborate cost accounting systems that readily compute profits on a per-job basis. In order to comply with V–T, many small businesses would have to go through the unproductive exercise of altering their accounting systems. This would be the case for a per-contract profit limitation such as V–T *regardless of what accounting rules are required by regulation.*

Many small firms would probably refuse Government work rather than alter their accounting systems. Since the benefits to be derived from forcing small firms to adopt more sophisticated accounting systems do not justify the administrative burden and resulting erosion of the defense industrial base, the Cost Accounting Standards Board exempted small businesses from cost accounting standards. Congress should apply a similar cost-benefit analysis to the per-contract accounting required by V–T, and retroactively exempt small business from the Act if it is not repealed.

PROBLEMS RESULTING FROM THE NONIMPLEMENTATION OF V-T SINCE IT BECAME APPLICABLE ON OCTOBER 1, 1976

V–T became applicable again as a result of the September 30, 1976, expiration of the Renegotiation Act of 1951. Despite almost four years of technical applicability, it has not been implemented by DOD and IRS. We do not criticize DOD and IRS for their actions. We believe that their decisions were based on the absence of regulations necessary to apply V–T to modern day procurements and the likelihood that Congress would render the matter moot by either retroactively extending Renegotiation or repealing V–T.

The passage of time his made it more burdensome and unfair to apply V–T retroactive to October 1976. As previously noted, V–T, even when applied prospectively, confronts small business with problems relating to tracing the ultimate use of the goods they sell and cost allocation. Given the absence of detailed guidance on how to apply V–T during this hiatus and the likelihood that Congress would likely render the matter moot, many small business contractors either never complied or have disposed of the records they would need to comply with V–T. Even assuming such records are available retroactive compliance would be unduly burdensome, if not in many cases impossible. That is why we concur with GAO's statement to the Committee that a retroactive application of V–T would be both uneconomical and unfair.

The nonimplementation of V–T has also resulted in another problem. Many small businesses have been forced to report amounts potentially due under V–T as contingent liabilities on their financial statements. This has precluded many firms from obtaining necessary financing. Congress should act to remove this cloud from small business contractor financial statements.

CONCLUSION AND LEGISLATIVE RECOMMENDATIONS

For all of the reasons described above, it is not cost effective for the Government to apply V–T to small business contractors. More specifically, the cost of administration by the Government would exceed the excess profits that would be recovered. It is also clear that the application of V–T to small business con-

tractors would lead to a significant erosion of the defense industrial base. From the course of the hearings to date, these points do not appear to be matters of contention.

If Congress concludes that a profit limitation such as V–T is necessary, small businesses, as defined by SBA regulations for procurement purposes, should be expressly excluded. A lesser acceptable alternative would be to set the pre-contract dollar threshold for such a limitation at such a level that small business would be effectively excluded. GAO in its statement recommended a dollar threshold of $10 million that would be adjusted for inflation for this purpose. We would find this acceptable. If the Committee finds the $10 million alternative too high, I would suggest as the least acceptable alternative to small business that a $5 million exclusion be adopted, as proposed in S. 2331 which is identical to the Patterson bill (H.R. 5433).

If it does nothing else, Congress should act to eliminate the retroactive application of V–T, to small business. For the reasons previously noted, a retroactive application of V–T to small business would be both unfair and cost ineffective.

Thank you for providing me with the opportunity to present my views. If you have any questions, or if I can be of assistance, please let me know.

FINANCIAL EXECUTIVES INSTITUTE,
Washington, D.C., July 3, 1980.

Hon. SAMUEL S. STRATTON,
Subcommittee on Investigations, Committee on Armed Services, U.S. House of Representatives, Rayburn House Office Building, Washington, D.C.

DEAR CHAIRMAN STRATTON: At the time we became aware of your sub-committee's planned hearing on HR 6247, the hearing schedule was full. Since we were unable to provide testimony at the hearing, we are pleased that you have kept the record open. We take this opportunity to share with you our particular perspective on HR 7247, a legislative proposal to mitigate the potentially severe problems relevant to the reimposition of the Vinson-Trammell Act.

Financial Executives Institute (FEI) is a professional organization of 10,000 individual members. They serve in senior executive financial positions in approximately 5,000 companies representing virtually all segments of the economy; primarily profitmaking companies. Through several national committees FEI promotes continuous improvements in accounting standards, disclosure, accountability, and financial measurement and reporting. These FEI committees interact, and maintain a dialogue with several agencies of the Federal Government, and with certain private sector rulemakers. In this particular instance the FEI Committee on Government Business is charged with the responsibility to represent the views of those members of FEI (many from small companies) whose responsibilities include planning, forecasting, recordkeeping and reporting on the doing-of-business with the Federal Government.

In the preparation of this statement, we attempted an examination of the reasoning behind both HR 7247, and the amendment to the DOD Authorization Bill, HR 6974, proposed by the Senate Armed Services Committee. Of particular significance were the informal remarks by Mr. Walton H. Sheley, Deputy Director, Procurement and Systems Acquisition Division of the United States General Accounting Office, in testimony before the Procurement Policy and Reprogramming Sub-Committee of the Senate Armed Services Committee.

Mr. Sheley said that it would be extremely difficult to require contractors to reconstruct data retroactively in order to comply with prospective implementing guidance to be issued, defining reporting requirement under the Vinson-Trammell Act.

We again reviewed the regulations proposed by IRS and DOD to implement the Vinson-Trammell Act. From our unique perspective there is no question; they will impose a mountainous and unproductive burden of paperwork for the *prime contractors* who already know whether they are engaged in the construction or manufacturing of complete new naval vessels or military aircraft. For subcontractors (many small businesses), identifying which of the *subcontracts* apply to new naval vessels and military aircraft is a managerial systems nightmare. Many parts and accessories used by the prime contractors are common to "new" "repairs" or "replacements." Thus proposed regulations will require a galaxy of correspondence between the many tiers of subcontractors and the

prime contractors and/or DOD. The Department of Defense is involved because they issue many blanket orders for components, such as communication equipment which go into depot stores. The contractor or subcontractor has no idea whether these orders are replacement parts or for new equipment.

The Department of Defense has estimated that the administrative burden on industry could exceed $80 million per year. We believe it would probably cost the Government another $80 million to administer, implement, review, and audit these reports each year. To "break even" i.e., zero cost to consumer/taxpayer; approximately $320 million dollars, after-tax of so-called excess profits would have to be recovered each year. Given the prior statistics of the Renegotiation Board, the current and historic profit levels of shipbuilding and military aircraft, and recent rates of inflation, implementation of Vinson-Trammell is decidedly negative economics.

We deeply appreciate the efforts of Mr. Price to alleviate the problem of retroactive application of the Vinson-Trammell Act. However, in our opinion HR 7247 requires modification if it is to effect a significant easing of the problem. The fact that many large contracts require performance over a period of from three to six or more years, and that an additional three to six years may be required for post performance audit before final payment may be received on the contract, negates the intended relief. Further, it must be recognized that the working of HR 7247 indicates that no subcontract regardless of its independent payment status, may be excluded from the need to maintain a capability of reporting under the Vinson-Trammell Act until the contract between the prime contractor and the government is closed with final payment.

Senator Morgan's proposed amendment to HR 6974 specifies that the profit limitations of the Vinson-Trammell Act will not apply to contracts and subcontracts where contract completion has occurred prior to October 1, 1981. While this would leave a number of large, long performance time contracts liable for the profit limitation provisions of the Act, should Congress see fit after due deliberation to leave it in place, it would remove the uncertainty for literally thousands of subcontractors who have delivered their products to the prime contractor and gone on to other endeavors.

During the June 25, 1980 hearings before the Subcommittee on Investigation of the Committee on Armed Services of the United States House of Representatives, two suggestions were made to clarify and alleviate the problem in HR 7247 and the Senate version.

(1) The Department of Defense recommended that the language be changed to provide: "the part of any contract or subcontract that is performed utilizing Fiscal Year 1981, or prior year appropriation, would be exempt from the Vinson-Trammell Act."

(2) The Machinery and Allied Products Institute (MAPI) recommended that "the waiver of Vinson-Trammell would apply to any contract or subcontract entered into during the period October 1, 1976 to October 1, 1981."

The Financial Executives Institute prefers the MAPI proposal but believes that either of the two recommendations is an improvement.

There were also many remarks about the Honorable Carl Vinson and his views of this legislation made during the hearing. Like you, we have a great deal of respect for Mr. Vinson, but we look at the legislative history in a different light. The Act bears his name, but his legislative proposal did not contain profit limitations. These were added as a floor amendment. Further, in November 1945, he introduced a bill, HR 4622, to repeal the profit limitation of the Vinson-Trammell Act. Subsequently, on June 20, 1947, the House Armed Services Committee unanimously reported a new bill, HR 3051 that was passed by the House of Representatives. This was subsequently reported unanimously from the Senate Committee on Armed Services, but not acted upon by the Senate in the log jam during the closing days of that Congress.

Carl Vinson wisely gave us legislation that created a modern Navy prior to World War II, but there is strong evidence that he did not favor the profit limitations, with which his name is now linked.

We appreciate the opportunity to provide these comments. We are available and pleased to provide whatever help we can to assist in an equitable legislative solution to this problem.

Yours truly,

WILLIAM M. SCHOFIELD,
Director, Government Relations.

Mr. STRATTON. The subcommittee will stand adjourned, subject to the call of the Chair.

[Whereupon, at 5:55 p.m., the subcommittee was adjourned, subject to the call of the Chair.]

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